STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

MidAmerican Energy Company	:	
	:	
Proposed general rate increase for electric service. (Tariffs filed December 16, 2013.)	:	**14-0066**
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	:	

<u>PROPOSED ORDER</u>

September 4, 2014

TABLE OF CONTENTS

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	:	
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PROPOSED ORDER

By the Commission:

I. PROCEDURAL HISTORY

On December 16, 2013, MidAmerican Energy Company ("MidAmerican", "MEC" or the "Company") filed new tariff sheets identified as Ill. C. C. No. 10, hereinafter referred to as "Filed Rate Schedule Sheets," by which it proposed a general increase in electric rates, effective February 1, 2014.

Notice of the filing was posted in public and conspicuous places in MidAmerican's commercial office in Moline, Illinois and published twice in newspapers of general circulation throughout MidAmerican's electric service area, in accordance with the requirements of Section 9-201(a) of the Public Utilities Act ("Act") (220 ILCS 5/9-201(a)) and the provisions of 83 Ill. Adm. Code 255.

An examination of the Filed Rate Schedule Sheets resulted in a determination by the Illinois Commerce Commission ("Commission" or "ICC") to enter upon hearings concerning the propriety of the proposed general increase in electric rates and that, pending hearings and a decision thereon, the Filed Rate Schedule Sheets should not be allowed to become effective. On January 23, 2014, the Commission entered an Order suspending the Filed Rate Schedule Sheets to and including May 16, 2014. On May 7, 2014, the Commission resuspended the Filed Rate Schedule Sheets to and including November 16, 2014.

By letter dated January 17, 2014, the Administrative Law Judge ("ALJ") notified MidAmerican of certain deficiencies in its filing in accordance with 83 Ill. Adm. Code 285, Standard Filing Requirements for Electric, Gas, Telephone, Water and Sewer Utilities in Filing for an Increase in Rates. The deficiency letter required MidAmerican to provide various revised and additional schedules or an explanation as to why certain schedules need not be provided. MidAmerican provided information responsive to the deficiency letter. There are no outstanding deficiencies and MidAmerican complied with all other Standard Filing Requirements for electric utilities.

The ALJ granted Deere & Company ("Deere") and the Department of Defense and all other Federal Executive Agencies ("DoD" or "DoD/FEA") leave to intervene (collectively, "Intervenors").

Pursuant to notice given in accordance with the law and the rules and regulations of the Commission, a duly authorized ALJ held a hearing at the Commission's offices in Chicago, Illinois on June 24, 2014. MidAmerican, Staff of the Commission ("Staff"), Deere and DoD entered appearances.

At the evidentiary hearings, eight witnesses on behalf of MidAmerican, and three witnesses on behalf of Staff, presented testimony and exhibits. The remaining pre-filed testimony and exhibits were entered through affidavits. On June 24, 2014, the ALJ marked the record "Heard and Taken."

The following witnesses testified on behalf of MidAmerican: Dean A. Crist (DAC 1.0, DAC 2.0); Rick R. Tunning (RRT 1.0, RRT 2.0, RRT 2.1, RRT 2.2, RRT 2.3, RRT 2.4, RRT 3.0, RRT 3.1, RRT 3.2, RRT 3.3); Mary Jo Anderson (MJA 1.0, MJA 2.0, MJA 3.0, MJA 3.1); James H. Vander Weide (JHV 1.0, JHV 2.0, JHV 3.0, JHV 3.1); Naomi G. Czachura (NGC 1.0, NGC 1.1, NGC 2.0, NGC 2.1, NGC 3.0, NGC 3.1); Charles B. Rea (CBR 1.0, CBR 1.1, CBR 2.0, CBR 2.1, CBR 3.0, CBR 3.1); Debra L. Kutsunis (DLK 1.0, DLK 1.1, DLK 2.0, DLK 2.1, DLK 3.0); Dehn A. Stevens (DAS 1.0, DAS 1.1, DAS 2.0); Spencer T. Moore (STM 1.0, STM 2.0); Melissa A. Grannes (MAG 1.0, MAG 1.1, MAG 2.0, MAG 2.1, MAG 3.0, MAG 3.1).

The following witnesses testified on behalf of Staff: Burma C. Jones (Staff Ex. 1.0, Staff Ex. 10.0, Staff Ex. 10.1); Bonita A. Pearce (Staff Ex. 2.0, Staff Ex. 11.0, Staff Ex. 11.1); Richard W. Bridal II (Staff Ex. 3.0, Staff Ex. 12.0); Dianna Hathhorn (Staff Ex. 4.0, Staff Ex. 13.0, Staff Ex. 13.1); Daniel G. Kahle (Staff Ex. 5.0, Staff Ex. 14.0); Michael McNally (Staff Ex. 6.0, Staff Ex. 15.0 Corrected, Staff Ex. 15.1); Alicia Allen (Staff Ex. 7.0, Staff Ex. 16.0); Yassir Rashid (Staff Ex. 8.0); Richard J. Zuraski (Staff Ex. 9.0, Staff Ex. 9.1).

Jeffrey S. Kaman testified on behalf of Deere.

The following witnesses testified on behalf of DoD/FEA: Michael P. Gorman (DoD/FEA Ex. MPG 1.0, DoD/FEA Ex. MPG 1.1 – 1.15; DoD/FEA Ex. MPG 3.0, DoD/FEA Ex. MPG 5.0); Greg R. Meyer (DoD/FEA Ex. GRM 2.0, DoD/FEA Ex. GRM 4.0, DoD/FEA Ex. GRM 6.0).

MidAmerican, Staff, and Deere filed Initial Briefs on July 22, 2014 and Reply Briefs on August 7, 2014.

DoD filed a Reply Brief on August 5, 2014. On August 7, 2014, MidAmerican filed a Motion to Strike the DoD's Reply Brief. Staff also filed a Motion to Strike a portion of the DoD's Reply Brief on August 8, 2014. On August 12, 2014, DoD, MidAmerican and Staff filed a Joint Unopposed Motion to withdraw DoD's Reply Brief as well as Staff's and MidAmerican's Motions to Strike, which was granted on August 22, 2014.

The ALJ served a Proposed Order on September 4, 2014. Briefs on Exceptions were filed September 25, 2014. Reply Briefs on Exceptions were filed October 9, 2014.

II. BACKGROUND

MidAmerican is a subsidiary of Berkshire Hathaway Energy Company f/k/a MidAmerican Energy Holdings Company. MidAmerican is an electric and gas distribution utility serving customers in the states of Illinois, Iowa, South Dakota and Nebraska. During calendar year 2012, MidAmerican served 41 Illinois communities, including Moline, East Moline, and Rock Island and approximately 84,952 customers with approximately 2.042 million MWh of electricity sold to its Illinois customers. In its Illinois service territory, MidAmerican owns approximately 60 miles of 345 kV transmission lines, 106 miles of 161 kV transmission lines and 78 miles of 69 kV transmission lines, totaling over 244 miles of transmission lines.

MidAmerican's last electric rate case occurred in 1992 (Docket No. 92-0357). After 1992, there were two electric rate decreases resulting from the implementation of the Commission’s decision in Docket No. 96-0510, one in 1996 of approximately 13.3% and another in 1998 of approximately 1.7%. Delivery service rates were adopted for MidAmerican in Docket Nos. 99-0122/99-0130 and 01-0444. MidAmerican Ex. DAC 1.0 at 4, ll. 32-69.

In this proceeding, MidAmerican indicated that its Filed Rate Schedule Sheets would increase annual jurisdictional electric revenues by a total of approximately $21,593,000 or an average increase of 16.9 percent over test period pro forma electric revenues for 2012.

Dean A. Crist, Vice President of Regulation, described the principal components of MidAmerican's current rate filing. Mr. Crist testified that, since the time of filing its last electric rate case, MidAmerican’s costs increased as a result of increased operating costs including the costs of materials and supplies, labor and employee benefits. During this time, MidAmerican continued to construct electric generation, transmission and distribution facilities.

III. TEST YEAR

For this proceeding, MidAmerican selected a historic test year consisting of the 2012 calendar year with pro forma adjustments. No party objected to the test year selected by MidAmerican. The Commission finds MidAmerican’s proposed test year reasonable for purposes of establishing Illinois jurisdiction electric rates in this proceeding.

It is MidAmerican’s position that the test year total operating revenue is $180,062,000. The test year operating income statement proposed by MidAmerican reflects the Company’s revised proposed rate increase of $20,939,000 and a rate of return on rate base of 7.721%. This reflects modifications to MidAmerican’s original filed position and also that MidAmerican accepted certain adjustments proposed by Staff, and in part, the DoD. MidAmerican Ex. RRT 3.1 Revised Schedule A-2.

Staff asserts that MidAmerican's total operating revenue is $174,902,000 and proposes a rate of return on rate base of 7.14%. Staff Initial Brief, Appendix at 1. The DoD recommends an overall rate of return on rate base of 6.98%. DoD/FEA Ex. MPG 1.1.

IV. RATE BASE

A. Uncontested Rate Base Issues

Initially, MidAmerican proposed an Illinois jurisdictional original cost rate base, including certain appropriate adjustments, associated with the provision of electric service of $343,949,000.[1] Staff proposed several adjustments to rate base, as described below, that were accepted by MidAmerican to narrow the issues in this proceeding and without regard to the merit of the adjustments. After accepting these proposed adjustments, MidAmerican's proposed Illinois jurisdictional original cost rate base is $334,836,000.[2] Deere and DoD did not take a position with regards to these adjustments.

The Commission finds these adjustments to be reasonable for the reasons outlined below.

1. Utility Plant in Service

Staff and MidAmerican agreed on the proposed rate base pro forma adjustments relating to the non-Illinois electric rate base, Neal 3 environmental, Neal 4 environmental, railcar purchased, OGS – AQCS emission control, Neal 4 outage, sub 48 Silvis transformer, Colona 69-13 kV substation, Neal 3 air heater replacement, OGS CAMP projects, Neal 1 & 2 life change and the depreciation adjustments summarized on MidAmerican Schs. B-2.1 through B-2.10 and B-2.11 through B-2.13 included as part of the filing requirements. MidAmerican Ex. MJA 2.0, at 3, ll. 29-35; see also MidAmerican Ex. STM 1.0. Staff found the capital additions to be prudent, used and useful. Staff Initial Brief at 2; Staff Ex. 8.0 at 2; MidAmerican Schedule F-4.

Additionally, Staff recommended that the Commission approve MidAmerican's write-down of Illinois generation assets pursuant to the 1997 legislation, to be recovered through rates as a regulatory asset for ratemaking purposes. Staff Ex. 2.0 at 7. MidAmerican wrote down the carrying value of generating assets used to serve Illinois ratepayers following 1997 legislation that restructured the Illinois electric industry. *Id*. at Attachment B. MidAmerican reduced the carrying value of these assets for financial reporting purposes; however, MidAmerican also recorded the amount of the write-down

[1] MidAmerican Ex. MJA 1.0 at 2, line 34, MidAmerican Ex. RRT 1.2, Schedule B-1.

[2] MidAmerican Ex. RRT 3.1 Revised Schedule A-2

as a regulatory asset that the Commission had never approved or considered for recovery in rates. *Id*. Accordingly, the write-down of the plant was offset by the establishment of the regulatory asset and, thus, the write-down produced no impact on regulatory rate base in this proceeding. *Id*. Staff noted the accounting treatment is proper and supportable and that the Company did not object to the adjustment or recommended language. Staff Ex. 2.0, Attachment C. The Commission finds the establishment of the regulatory asset is reasonable as reflected the Findings and Ordering section of this Final Order.

2. Cash Working Capital

Cash Working Capital ("CWC") is the amount of funds required from investors to finance MidAmerican's day-to-day operations. The term "lag days" refers to the time period between the rendering of the service and the payment by the customer. "Lead days" refers to the time period between the incurrence of the expense and the payment by MidAmerican. The net day lag is the difference between revenue lag days and expense lead days. In its direct filing, MidAmerican developed a CWC amount of $1,488,000 calculated based on the net lag methodology. MidAmerican Sch. B-8, at 1. With this approach, for each expense classification, the net day lag for that expense classification is multiplied by the daily expense for that expense classification to produce the CWC requirement for that expense classification. The individual expense classifications are then summed to yield the total CWC requirement.

In its direct testimony, Staff calculated its CWC requirement of $280,000. Staff's calculation of CWC used zero lag days for the pass-through tax, Illinois Electricity Excise Tax; included an additional pass-through tax, municipal utility taxes, with zero lag days and 45.70 lead days; and included Energy Assistance Charges with zero lag days. Staff Ex. 5.0 at 2-3, ll. 40-46; Staff Initial Brief at 3.

MidAmerican, in its rebuttal filing, accepted Staff's proposed adjustments to CWC, subject to the use of the correct Energy Assistance Charges. MidAmerican Ex. NGC 2.0 at 3, ll. 36-39. Additionally, MidAmerican agrees with Staff witness Jones' testimony that the under-over collection of Fuel Adjustment Clause ("FAC") does not affect cash working capital and therefore should not be included in rate base. MidAmerican Ex. MJA 3.0 at 3, ll. 30-34.

In its rebuttal filing, Staff incorporated the modifications suggested by MidAmerican and calculated a CWC requirement of $200,000, assuming all other Staff changes are accepted. In surrebuttal testimony, MidAmerican updated the CWC, and calculated a CWC requirement of $253,000. MidAmerican Ex. NGC 3.1.

The Commission finds the CWC methodology proposed by Staff and MidAmerican reasonable. The final balance of CWC, which was calculated using the approved revenue requirement, is in Appendix A of this Order.

3. Accumulated Deferred Income Tax Related to FAC

Staff proposed an adjustment to accumulated deferred income tax ("ADIT") to (1) reflect a revision to Schedule B-9, IL Electric ADIT, provided by the Company, and (2) remove ADIT on the over/under collection of the Fuel Adjustment Clause ("FAC") from rate base. Staff Ex.1.0 at 5. MidAmerican accepted Staff's adjustment. MidAmerican Ex. MJA 3.0 at 3, ll. 28-30; see Staff Ex. 10.00, Sch. 10.08.

4. Material and Supplies

MidAmerican accepted Staff's material and supplies A/P adjustment. MidAmerican Ex. MJA 2.0 at 3, ll. 38-39; see Staff Ex. 1.00, Sch. 1.04, column (d).

The amount of rate base was reduced by the amount of accounts payable associated with materials and supplies inventory. Staff noted that the Company's proposed 13-month average of materials and supplies was not reduced by the associated accounts payable, and the Company's shareholders do not incur any cost of financing when materials and supplies were purchased on account with a vendor until the account is paid. An account payable represents "vendor financing" of purchased merchandise until it has been paid in full. Since the vendor is in effect financing these purchases until paid, the Company's shareholders have no investment in the related materials and supplies inventory. The materials and supplies inventory should be reduced by the amount of accounts payable related to such inventory because the Company should not earn a return on investment (purchased inventory) until it has been funded by the Company's shareholders. Staff Ex. 2.0, Sch. 2.01.

5. Fossil Fuel Inventory

MidAmerican accepted certain aspects of Staff's adjustment related to fossil fuel inventory. MidAmerican proposed an alternative calculation to reflect the significant increase to coal transportation costs beginning in 2013. MidAmerican Ex. MJA 2.0 at 4, ll. 53-55. Staff accepted MidAmerican's alternative adjustment because it reflects the five-year average quantities while reflecting current prices. Staff Ex. 11.0 at 3, ll. 48-50.

6. Original Cost Determination

Staff witness Pearce testified that requirements for preservation of records are associated with an original cost determination. Staff Ex. 2.0 at 6. The Commission's Rules on Preservation of Records of Electric Utilities, requires the preservation of specific records. 83 Ill. Adm. Code 420. Under this rule, certain records must be maintained for a specific number of years relative to the date as of which original cost of plant has been unconditionally determined or approved by the Commission in an original cost determination proceeding or a rate case. *Id*.; see also, Staff Ex. 2.0 at 6. Accordingly, Staff recommended that the Commission approve the actual December 31, 2012, plant balances, as reflected on MidAmerican Sch. B-4 and supporting schedules, for purposes of original cost determination. MidAmerican did not object to Staff's recommendation. The Commission finds that the original cost determination is reasonable as reflected the Findings and Orderings section of this Order.

7. Planned Retirement of Generation Stations

As part of a rate design issue, MidAmerican indicated that it is possible that it will retire generation allocated to Illinois. In light of these possible retirements, Staff recommended that MidAmerican be required to file a quarterly report, "Plan for Meeting Generation Needs Beyond 2015" on e-Docket in this proceeding with a copy to the Manager of Accounting. Staff Ex. 11.0 at 3-4, ll. 55-70.

MidAmerican agreed to file a quarterly report using the same format as the previous Staff Financial Monitoring Project reports at the time the generation is retired. MidAmerican Ex. NGC 3.0 at 3, ll. 26-33. MidAmerican testified this information would provide the Commission with sufficient information to determine if further investigation of the reasonableness of MidAmerican's base rates will be needed. MidAmerican noted that it has already provided an estimate of the impact on base rates of the retirement of the subject generation units in response to Staff Data Request BAP 16.01. See Staff MidAmerican Joint Cross Ex. 1.

Specifically the parties agreed that prior to retirement of any of the four generating units, Neal Units 1 and 2 and Walter Scott Units 1 and 2, MidAmerican will file a quarterly status report in response to each of the following Staff recommendations:

(i) The operational status of each generation station, e.g., fully operating, partially operating, pre-closure, or closed;
(ii) The current date of planned closure for each generation station;
(iii) Other developments that may impact the planned closure of these generation stations;
(iv) The status and description of a plan to implement a change in base rates to reflect the changes in the operational status of the above listed generation stations and other relevant developments; and
(v) The status and description of a plan for cost recovery for capacity and energy purchases incurred as a result of changing the operational status of a generation station.

In its Initial Brief, Staff suggested that these quarterly reports use the more descriptive title: "Plan for Meeting Generation Needs Beyond 2015", as proposed in Staff witness Pearce's rebuttal testimony. Staff Exhibit 11.0, 4-5; Staff Initial Brief at 9. These quarterly reports shall be filed beginning with the quarter ending December 31, 2014, on e-Docket under this proceeding with a copy to the Manager of the Accounting Department of the Commission until all four generating units are retired, as agreed to in MidAmerican's response to Staff DR BAP 17.01(f). Staff-MidAmerican Joint Cross Ex. 1.0.

The parties further agreed that when any one of the four generating units is retired, MidAmerican shall file the Staff Financial Monitoring Project report as agreed to by Staff and MidAmerican at the evidentiary hearing. MidAmerican Ex. NGC 3.0 at 3; Staff-MidAmerican Joint Cross Ex. 1.0.

Subpart (a) of the response to BAP 17.01 indicates the Staff Financial Monitoring Project report will specifically include the following information:

(i) A narrative description of the methodologies for allocating amounts of service and jurisdiction;
(ii) Total company rate base;
(iii) Total company income statement;
(iv) Total company capitalization and return;
(v) Illinois jurisdictional rate base by utility (electric and gas);
(vi) Illinois jurisdictional income statement by utility (electric and gas);
(vii) Illinois jurisdictional return information by utility (electric and gas).

Subpart (b) of the response to BAP 17.01 includes a Confidential Attachment which is an example of the Staff Financial Monitoring Project report that Staff and the Company agreed the Company would file on e-Docket under this proceeding.

Subpart (c) of the response to BAP 17.01 indicates the Staff Financial Monitoring Project report will be filed at the end of each quarter for the four quarters immediately following the retirement of any of the referenced generating units. Subpart (d) of the response to BAP 17.01 indicates MidAmerican would file the Staff Financial Monitoring Project reports with the Manager of the Accounting Department of the Commission.

B. Contested Rate Base Issues

1. Rate Base Adjustment Related to Performance Incentive Plan

Section V.C.1 infra discusses Staff's proposed adjustment to Performance Incentive Plan ("PIP") incentive compensation. In the event that the Commission denies any of the incentive compensation, MEC agrees with Staff's methodology for calculating the rate base adjustment for PIP incentive compensation. MEC Ex. MJA 3.0 at 3.

2. Pension Asset Adjustment

MidAmerican's Position

MidAmerican states its proposal to include prepaid pension expenses in rate base is reasonable because this amount must be financed by MidAmerican, i.e., with shareholder dollars. Amounts contributed to the pension trust, and earnings on such amounts, must be used solely for plan benefits or plan administration and are not available for MidAmerican's general use. Accordingly, MidAmerican proposes to include $786,790 of prepaid pension expense in its Illinois rate base. Staff Ex. 4.0, Att. A; see also MidAmerican MJA 3.1, Sch. B-1 Surrebuttal, line 11. This amount represents the cumulative amount of pension plan contribution in excess of amounts expensed. *Id*., Att. A at 1. MidAmerican Ex. RRT 23.0 at 5, ll. 87-99; citing *Southern Company Services, Inc*., Docket Nos. ER08-129-000 and ER08-129-001, Order on Tariff Filing, 122 FERC ¶ 61,218 (March 10, 2008). MidAmerican observes its proposed accounting adjustment is consistent with ratemaking principles and consistent with the ratemaking treatment adopted by the Federal Energy Regulatory Commission ("FERC").

Staff proposed an adjustment to disallow MidAmerican's pension asset and related ADIT from rate base. Staff Ex. 4.0 at 2, ll. 42-46. Staff proposed to remove the prepaid pension asset from rate base. Staff contends this adjustment is necessary because MidAmerican has not demonstrated that the pension asset was created with anything other than ratepayer funds. *Id*. Staff cites to various Commission orders where the Commission has denied the inclusion of pension assets in rate base because the pension assets were not shown to be from a source other than ratepayer supplied funds.

MidAmerican argues that Staff's reliance on past rate case orders may offer the Commission some guidance on this issue, but the Commission decision in this case must be based on the record evidence and not the specific facts and findings in other dockets. 220 ILCS 5-10-103; 220 ICLS 5/10-201(e)(iv)(A).

MidAmerican contends the evidence in this case demonstrates that the pension expenses must be financed. As MidAmerican explained in testimony, funding in excess of amounts included in rates as expense must be financed, and as such, it is appropriate to earn a return on the pension asset. MidAmerican Ex. RRT 2.0 at 9, ll. 177-178.

Staff, on the other hand, contends that the source of funds for the test year pension contributions funding the prepaid pension asset is ratepayer supplied funds. MidAmerican Ex. RRT 2.0 at 8, ll. 147-149. As Staff indicated in a data request response, "ratepayer supplied funds are funds provided through normal operating revenues of a utility." MidAmerican Ex. RRT 2.5. MidAmerican pointed out that using Staff's logic, a utility is not allowed to use any retained earnings to make investments. Consequently, MidAmerican could not be able to include a substantial amount of investment in rate base because MidAmerican has invested significant amounts in utility plant using retained earnings, or what Staff labels as "ratepayer-supplied funds." See MidAmerican Ex. RRT 2.5 and MidAmerican Ex. RRT 2.0 at 9, ll. 161-169.

Staff's argument ignores the general rule established by the United States Supreme Court that ratepayers do not acquire a legal or equitable interest in utility property, i.e. the revenue generated by service belongs to the utility. *Board of Pub. Util. Comm'rs. v. New York Tel. Co*., 271 U.S. 23, 31-32 (1926).

In this docket, MidAmerican argues it has demonstrated its accounting treatment of its pension asset is consistent with the law and ratemaking principles. MidAmerican's cost of service includes return on the prepaid pension expense, but MidAmerican's cost of service is reduced by the associated pension income, i.e. the earnings from pension trust embedded in the net periodic benefit cost that is recorded to the income statement.

MidAmerican points out Staff's proposed disallowance is inconsistent with FERC's accounting treatment because Staff fails to recognize that MidAmerican must finance the pension asset, clearly as a matter of law and by matter of normal business operations. MidAmerican's financing responsibility is not based on ratepayer funding.

MidAmerican acknowledged that FERC does not have jurisdiction over the rates to be established in this rate case. MidAmerican, however, noted that FERC's explanation of proper accounting treatment related to pension assets should not be ignored out of hand as Staff suggests. Staff Ex. 13.0 at 5, ll. 96-112. The Commission's Uniform System of Accounts for Electric Utilities, 83 Ill. Admin Code Part 415, incorporates FERC's system of accounts by reference subject to certain exceptions.

Staff also urges the Commission to disregard this FERC order because it relates to a formula rate proceeding. *Id.*, ll. 103-112. Staff makes a distinction where there is no difference in ratemaking treatment. Regardless of whether the revenue requirement for a utility is approved through an annual formula rate mechanism or approved through a historical test year, costs and benefits still must be balanced or "matched."

MidAmerican points out that the Illinois legislature charged the Commission with setting rates which are "just and reasonable" not only to ratepayers but to the utility and its stockholders. *Business and Professional People for the Pub. Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 208-209 (1991) (citing 220 ILCS 5/1-102 and 5/9-201); see also 220 ILCS 5/1-102(d). MidAmerican contends it is not reasonable to allow an accounting adjustment that offsets costs to ratepayers but does not recognize the corresponding cost to the utility and its shareholders of obtaining that cost offset. Consequently, MidAmerican urges the Commission to approve the $786,790 of prepaid pension expense in its Illinois rate base since the pension income is used to off-set MidAmerican's pension expense. See generally Schedules B-1 and B-16 Surrebuttal.

As an alternative resolution to this issue and consistent with ratemaking principles and established FERC accounting treatment, MidAmerican states it does not object to the Commission removing the pension asset from rate base and making a corresponding adjustment to remove pension income currently proposed to off-set the cost of service. MidAmerican Ex. RRT 2.0 at 10-11, ll. 191-209. MidAmerican also contends its alternative proposal is just and reasonable to both ratepayers and shareholders since its approach is consistent with the matching principle.

Staff's Position

Staff argues that a disallowance from rate base for the Company's pension asset and related accumulated deferred income taxes ("ADIT") is required since the Company has not demonstrated that the pension asset was created with anything other than ratepayer funds. Staff Ex. 13.0, Sch. 13.01. In Staff's view, this position is in accordance with multiple Commission orders, in which the Commission has repeatedly held that shareholders are not entitled to a return on ratepayer-supplied funds. The Company disagrees with the Commission's well-established definition of ratepayer-supplied funds and instead suggests an inapplicable FERC ruling should provide guidance.

Staff argues the evidence presented by the Company in this case simply does not distinguish this case from prior Commission rulings on the same subject. See generally, Staff Ex. 4.0 at 3-11. The Company stated that contributions to the pension plan have the effect of reducing pension expense, therefore the investment "made by the Company" to achieve such cost reductions should be included in rate base. Staff Ex. 4.0 at 4. In Staff's opinion, this argument fails, however, since it does not recognize the fact that the contributions that reduce pension expense were made by the Company with ratepayer-supplied funds, so the Company is not making an investment of any sort. *Id*. at 6. The Company stated that the source of funds for the test year pension contributions was "general corporate funds similar to the settlement of most other commercial obligations" and that "no financing or other acquisition of funds was made specifically in contemplation of the funding." *Id*. at 5. Staff argues that, since "no financing or other acquisition of funds was made specifically in contemplation of the funding[,]" the only possible conclusion which can be drawn is that the funds were supplied by ratepayers.

Multiple prior Commission orders deny inclusion of a pension asset on the basis that it was not reasonable to allow the shareholders a return on ratepayer supplied funds. See, Staff Ex. 13.0 at 4; see also *GTE North Inc*., ICC Order Docket Nos. 93-0301/94-0041 (Cons.), 13, 1994 WL 711847 (Ill.C.C.) *9 (October 11, 1994).

In rebuttal and surrebuttal testimony, the Company maintained only that it disagrees with the Commission's definition of ratepayer funds, and instead presented FERC order ER08-129-000/ER08-129-011 ("FERC Order") as guidance on the issue. MEC Ex. RRT 2.0 at 8-11; MEC Ex. RRT 3.0 at 4. In Staff's view, the FERC Order is irrelevant and inapplicable to the issue at hand. First, the FERC Order is not binding on the Commission in this proceeding as the Commission is not considering FERC-jurisdictional rates, but rather Illinois intrastate delivery service rates. Staff Ex. 13.0 at 5. Second, the FERC Order concerns a process to propose revisions to formula rates under the Open Access Transmission Tariff, wherein rates are updated annually based upon a pre-approved formula. *Id*. The FERC Order itself made a distinction in the treatment of the pension asset based on formula rates. *Id*. The FERC Order did not allow amounts related to the pension asset in rate base prior to May 2003, the effective date of formula rates. Staff Ex. 13.0, Att. A at 10. Third, the Company's alternative proposal based on the FERC Order would eliminate any ratepayer benefit of reduced pension expense resulting from the ratepayer-provided asset. Staff Ex. 13.0 at 6. According to Staff, the Company ignores the fact that the FERC Order that MEC considers to be "insightful" (MEC Ex. RRT 3.0, 5) upon this issue is a formula rates decision. Instead, the Company points only to a discussion of the issue which discusses financing of the asset. *Id*. at 5-6.

Commission Analysis & Conclusion

MidAmerican proposes to include $786,790 of prepaid pension expense in its Illinois rate base. Staff opposes the inclusion of the pension expense, arguing that the Company failed to show the pension asset was funded by anything other than ratepayer funds. According to Staff, the evidence presented by the Company in this case simply does not distinguish this case from prior Commission rulings on the same subject. The Commission agrees.

As Staff notes, prior Commission decisions denied inclusion of prepaid pension asset because they were created by ratepayer supplied funds. In the current proceeding, rather than show the funds supplying the pension asset were from a source other than ratepayer funds, MidAmerican attempts to redefine the Commission's definition of ratepayer supplied funds. MidAmerican argues that because the Company must finance the pension asset as a matter of law and normal business operations, MidAmerican's financing responsibility is not based on ratepayer funding. This argument is not persuasive.

The Commission notes that the FERC Order is not binding on the Commission in this proceeding; however, the Commission may look to FERC Orders for guidance. Nevertheless, even recognizing the FERC accounting treatment discussion, Staff is correct in that the Company failed to show that the accumulated pension funds that generated the excess income earned over the net periodic pension cost, i.e. what generates the reduction in pension expense, is not from ratepayer supplied funds.

Furthermore, MidAmerican mischaracterizes Staff's statement of what constitutes ratepayer funds. MidAmerican references Staff's response to a data request stating that "ratepayer supplied funds are funds provided through normal operating revenues of a utility." MidAmerican Ex. RRT 2.5. The Company then extrapolates that all retained earnings are generated from "operating revenues." This is incorrect. Accordingly, the Commission finds that MidAmerican failed to show that the pension expense was funded by non-ratepayer funds, and therefore the pension expense should be excluded from rate base.

C. Approved Rate Base

The Commission concludes that MidAmerican's Illinois jurisdictional electric approved rate base for the 2012 test year with pro forma adjustments is $334,118,000, as shown in the attached Appendix A. The table below depicts the components of the approved rate base.

	000s
Gross Plant In Service	$774,116
Less: Accumulated Depreciation and Amortization	(381,761)
Net Utility Plant in Service	392,355
Additions to Rate Base	
Cash Working Capital	192
Materials and Supplies	4,600
Allowances	284
Fuel Stock	10,121

Nuclear	5,467
Accumulated Provisions for Pensions	
Budget Plan Balances	926
Deductions from Rate Base	
Customer Advances for Construction	(740)
Customer Deposits	(151)
ITC 3%	(6)
Accumulated Deferred Income Taxes	(78,679)
Self-Insurance Reserve Quad Cities	(251)
Rate Base	$334,118

V. REVENUE REQUIREMENT – OPERATING REVENUES AND EXPENSES

A. Overview

In its direct testimony, MidAmerican indicated that for the 2012 historical test year, its Illinois jurisdictional electric tariff revenues were $132,522,000. Originally, MidAmerican proposed to increase rates and revenues by $21,593,000; after accepting certain adjustments to its proposal recommended by Staff and, in part, the DoD, MidAmerican is now proposing a rate increase of $20,939,000.

B. Uncontested Adjustments to MidAmerican's Proposal

Staff proposed numerous adjustments to the Company's operating income statement, which MidAmerican did not contest for purposes of narrowing the issues in this proceeding. Deere and DoD did not take positions with respect to the adjustments. The Commission finds the uncontested portion of MidAmerican's revenue requirement is reasonable and adopts the following adjustments.

1. Retirement Plan

MidAmerican accepted the retirement plan cost adjustments proposed by Staff. MidAmerican Ex. RRT 2.0 at 4, l. 46; Staff Ex. 4.0 at 11, ll.262-271. Staff adjustments reflected a reduction from operating expenses to reduce the 2012 test year amounts for retirement plan costs to a three-year average balance for the retirement plan costs. The adjustment uses the same methodology as the Company's adjustment to retirement plan costs in Schedule C-2.3, except it is based upon the most recent actuarial reports available. It also corrects an allocation error disclosed in MidAmerican's supplemental response to Staff DR DLH 2.10. *Id*.

2. Industry Dues

MidAmerican originally proposed to include certain industry dues in its operating statement. MidAmerican Sch. C-1. Staff recommended that these costs be excluded. Staff Ex. 3.0 at 5-6. MidAmerican accepted Staff's adjustment to exclude industry association dues, which removes expenses associated with certain industry association dues. Staff Ex. 3.0 at 5-6, ll. 102-161; MidAmerican Ex. RRT 2.0 at 3, ll. 43-45; MidAmerican Ex. RRT 2.1, Sch. C-1 Rebuttal.

3. Demonstration and Selling

MidAmerican originally proposed to include certain demonstration and selling expenses in its operating statement. MidAmerican Sch. C-1. Staff recommended that these costs be excluded. MidAmerican accepted Staff's adjustment to remove certain demonstration and selling expenses that Staff noted are promotional in nature or for goodwill purposes. Staff Ex. 3.0, at 8-11, ll. 182-238; MidAmerican Ex. RRT 2.0, at 3, ll. 44-47; MidAmerican Ex. RRT 2.1, Sch. C-1 Rebuttal.

4. Miscellaneous and General

MidAmerican accepted Staff's adjustment to the operating statement to remove certain miscellaneous general expenses. Staff Ex. 3.0 at 11-14, ll. 239-297; MidAmerican Ex. RRT 2.0 at 3, ll. 43-47; MidAmerican Ex. RRT 2.1, Sch. C-1 Rebuttal.

5. Payroll Taxes Associated with LTIP

As discussed below in Pro Forma Adjustments, MidAmerican removed the amount of executive incentive compensation included in the 2012 test year operating expenses. MidAmerican Ex. RRT 1.0 at 11, ll. 206-212, and MidAmerican Sch. C-2.12; see also MidAmerican Ex. MAG 1.0, ll. 188-201.

Staff recommended a further adjustment to the operating statement to remove payroll taxes associated with the LTIP incentive compensation expense that MidAmerican removed from its revenue requirement. Staff Ex. 3.0 at 14, ll. 302-308. MidAmerican accepted this adjustment. MidAmerican RRT 2.0 at 3, l. 45 and MidAmerican Sch. C-2.12 Rebuttal.

6. Income Tax Adjustment

MidAmerican accepted Staff's adjustment to include the adjustments recorded in 2013 to reconcile income tax expense booked in 2012 with the amounts on the 2012 federal and state tax returns. Staff Ex. 1.0 at 8-9, ll. 183-189; MidAmerican Ex. RRT 2.0 at 3, ll. 30-37; MidAmerican Ex. RRT 3.0 at 8, ll. 158-169; MidAmerican Ex. RRT 3.3.

7. Interest Synchronization

Both MidAmerican and Staff updated their respective interest synchronization calculations to reflect the changes to rate base for the uncontested issues. The parties agree with how interest synchronization is calculated. MidAmerican Ex. RRT 2.0 at 6-7, ll. 113-117.

8. Pro Forma Adjustments

a. Out of Period Income Tax Adjustment

MidAmerican presented an adjustment to increase income tax expense through the reversal of entries made during 2012 that modified income tax expense for periods prior to 2012. MidAmerican Ex. RRT 1.0 at 8, ll. 152-155. Since the increases to income tax expenses are not representative of ongoing expense relative to test year activity, it is reasonable to make this pro forma adjustment. The tax adjustments recorded in 2012 reconciled income tax expense booked during 2012 to the amounts reflected in the 2011 tax return that was filed in September 2012, and included new estimates for bonus depreciation relative to those that were originally contemplated at the time the books were closed for 2011. *Id*. at 8-9, ll.155-160. Since these adjustments pertain to 2011, and not 2012, they should not be included in the test year for this case. MidAmerican Ex. RRT 1.0 at 8-9, ll. 152-160 and MidAmerican Sch. C-2.6; MidAmerican Ex. RRT 2.0 at 3, ll. 30-36.

b. Depreciation on Rate Base

MidAmerican proposed an adjustment to increase depreciation expense for the depreciation associated with the rate base adjustments net of lower depreciation expense associated with a 2013 depreciation study. MidAmerican Ex. RRT 1.0 at 9, ll. 163-166; MidAmerican Sch. C-2.7. Staff did not contest the Company's adjustment. MidAmerican Ex. RRT 2.0 at 3, ll. 30-36.

c. Weather Normalization

MidAmerican presented a weather normalization adjustment to decrease test year operating revenue to account for the impact of unseasonable weather during the test year. MidAmerican Ex. RRT 1.0 at 9, ll. 176-178, and MidAmerican Sch. C-2.9; see also Section VIII.B.2. below for further discussion on the weather normalization adjustment.

d. Coal Transportation Costs

MidAmerican proposed an adjustment to reflect increases in cost of fuel for the effect of new, long-term coal transportation contracts MidAmerican entered into during 2012 with BNSF Railway and Union Pacific Railroad. These contracts took effect January 1, 2013, and replaced an expired contract with Union Pacific that had been in place for more than a decade. Prices under both new contracts are significantly higher than those under the expired Union Pacific contract. The adjustment is based on 2012 coal tonnages burned at MidAmerican-operated plants to which coal is delivered pursuant to these agreements. MidAmerican Ex. RRT 1.0 at 10, ll. 181-188; MidAmerican Sch. C-2.10; MidAmerican Ex. RRT 2.0 at 3, ll. 30-36.

e. Bad Debt Expense

MidAmerican made a pro forma adjustment to reduce bad debt expense for the application of a lower estimated accrual percentage. During 2012, MidAmerican accrued bad debt expense at approximately 0.49% of tariffed revenue. Based on favorable recent actual bad debt experience, MidAmerican believes a lower rate is appropriate. The adjustment reflects the difference between test year expense at a rate of 0.49% and that using a rate of 0.3% of 2012 tariffed revenue. MidAmerican Ex. RRT 1.0 at 10-11, ll. 198-203; MidAmerican Ex. RRT 2.0 at 3, ll. 30-36; and MidAmerican Ex. Sch. C-2.11.

f. Long-Term Incentive Partnership ("LTIP") Plan

MidAmerican removed the amount of executive incentive compensation included in the 2012 test year operating expenses. The adjustment decreased test year operating expenses for costs accrued for MidAmerican's LTIP plan. The LTIP plan, administered by Berkshire Hathaway Energy Company f/k/a MidAmerican Energy Holdings Company, provides incentive payments to selected participants based in large part on predominantly financial performance factors. MidAmerican is not seeking recovery for these costs at this time. MidAmerican Ex. RRT 1.0 at 11, ll. 206-212; MidAmerican Sch. C-2.12; see also MidAmerican Ex. MAG 1.0, ll. 188-201, and Subsection V.B.5 supra.

g. Customer Contract Revenue

MidAmerican proposed an adjustment that increases test year revenue to reflect the expiration of a customer contract and resultant return of the customer to tariff rates. MidAmerican Ex. RRT 1.0 at 11, ll. 215-217, and MidAmerican Ex. Sch. C-2.13; MidAmerican Ex. RRT 2.0 at 3, ll. 30-36.

h. Transmission Delineation – 69 kV Transmission Transfer

MidAmerican proposed an adjustment to decrease test year other operation and maintenance expense, increase test year depreciation expense and change the characterization of such costs from distribution to transmission to reflect the annualization of such changes that occurred September 1, 2012, in conjunction with the re-delineation of MidAmerican's 69 kV system. The reclassification of these assets was performed pursuant to orders in FERC Docket No. EL12-57-000, ICC Docket No. 11-0492 and Iowa Docket No. SPU-2011-0005. Jurisdictional cost shifts occurred because distribution costs are generally specifically assigned to the jurisdiction in which the assets are physically located, and transmission costs are generally allocated among all jurisdictions. MidAmerican Ex. RRT 1.0 at 11-12, ll. 220-229; MidAmerican Ex. Sch. C-2.14; MidAmerican Ex. RRT 2.0 at 3, ll. 30-36.

i. Environmental Chemical Costs

MidAmerican proposed an adjustment to increase test year operations expense for the estimated cost of chemicals to be consumed in the operation of environmental equipment being installed at Neal Unit 3, Neal Unit 4 and Ottumwa Generating Station. The chemicals include lime, urea and activated carbon. The adjustment applies the actual 2012 cost per megawatt hour generated for such chemicals at Walter Scott Unit 4 to the 2012 megawatt hours generated at Neal 3 and 4 and Ottumwa. MidAmerican Ex. RRT 1.0 at 13, ll. 250-257, and MidAmerican Ex. Sch. C-2.18; see also MidAmerican Ex. STM 1.0.

9. Rate Case Expenses

MidAmerican requested recovery of $181,000 in rate case expenses. Staff supports the recovery of MidAmerican legal and travel expenses after examining the evidence presented by MidAmerican. In regards to the recovery of rate case expenses for legal and travel expenses of $111,000, Staff found those costs to be just and reasonable based on the evidence.

As explained in Subsection V.C.5 below, the recovery of $70,000 for outside witness fees is in dispute.

<u>Legal Expenses</u>

MidAmerican presented evidence noting that MidAmerican primarily relied upon in-house attorneys for the preparation and prosecution of the case and that outside counsel is used only for consultation on specific and limited issues, thus limiting the incremental legal fees that are included in rate case expenses. MidAmerican Ex. DLK 2.0 at 5, ll. 95-98. MidAmerican presented evidence regarding outside counsel's expertise in rate case litigation, hourly rate and number of hours of work performed. Staff Ex. 5.0, Confidential Attachment A, see also MidAmerican Ex. DLK 3.1, Sch. A Surrebuttal.

Staff accepted the MidAmerican's projected rate case costs for outside counsel costs of $90,000. Staff Ex. 14.0 at 4, ll. 78-81. Staff noted that MidAmerican submitted documentation to support rate case costs through responses to Staff's data requests. The documentation included invoices for outside counsel. Staff Ex. 14.0 at 5, ll. 84-86.

<u>Travel Expenses</u>

Staff accepted the MidAmerican's projected rate case costs of $21,000 for travel, meals, lodging and supplies. Staff Ex. 14.0 at 4, ll. 78-81. Staff noted that MidAmerican submitted documentation to support rate case costs through responses to Staff's data requests. The documentation included invoices and support for travel, meals, lodging and supplies. Staff Ex. 14.0 at 5, ll. 84-86. These incremental costs are reasonably incurred since they related to supplies for the filing, and travel, meals and lodging for the hearing.

C. Contested Adjustments to MidAmerican's Proposal

1. PIP Incentive Compensation and Associated Payroll Tax and Pension Costs

MidAmerican's Position

MidAmerican objects to Staffs adjustment to disallow Performance Incentive Plan ("PIP") incentive compensation costs and associated payroll tax and pension costs. In order to ensure its employees are paid on comparable terms to others performing equivalent work, MidAmerican's compensation for non-represented employees consists of both base and incentive pay. MidAmerican Ex. MAG 1.0 at 3-5, ll. 32-72; MidAmerican Ex. MAG 1.1, Sch. A. MidAmerican states its PIP provides incentive awards to employees based on (1) the Company's performance related to goals based on the core principals, (2) the employee's individual achievement of goals based on the core principles, and (3) the employee's performance in addressing new issues and opportunities that may arise during the year. MidAmerican Ex. MAG 1.0 at 6. Each year MidAmerican's President establishes the overall annual goals for the Company, and those goals are driven by the Company's six core principals: customer service, employee commitment, financial strength, environmental respect, regulatory integrity and operational excellence. *See* MidAmerican Ex. MAG 1.2. At the end of the year, the President completes a review documenting the business achievements or goals accomplished for the current year for each core principal. MidAmerican states these achievements are the basis for any adjustments to the overall incentive budget for the year. MidAmerican Ex. MAG 2.0 at 6.

Staff proposed a series of adjustments to remove 100% of the effects of MidAmerican's PIP. These adjustments remove $971,026 of PIP compensation charged to expense from the revenue requirement and an additional $175,977 of capitalized PIP incentive compensation offset by associated accumulated depreciation and ADIT. Staff Ex. 12.0, Sch. 12.01. Additionally, Staff also recommended removing amounts of associated payroll taxes and pension costs associated with PIP compensation. Staff Ex. 12.0, Schs. 12.02 and 12.03.

MidAmerican takes exception to Staff's characterization of MidAmerican's incentive awards as subjective and discretionary. MidAmerican points out that incentive pay is highly aligned around the six core principles – starting with corporate goal formation and ending with individual incentive awards. Since all activities at MidAmerican tie in one way or another to the core principles, MidAmerican concludes it is appropriate for them to be the basis of individual goals and awards of incentive pay.

MidAmerican notes that the Commission specifically authorizes recovering incentive compensation in rates when ratepayer benefits accrue from a program. See *Northern Illinois Gas Company d/b/a Nicor Gas Company*, Docket No. 04-0779, Final Order at 44 (September 20, 2005) ("Nicor 2005 Order"). In developing the adjustment to remove all incentive compensation amounts, Staff did not challenge whether MidAmerican's incentive compensation expense meets the "ratepayer benefit" standard. Staff Ex. 3.0, ll. 434-442; Staff Ex. 12.0, ll. 104-107. Instead, with the exception of reviewing the goals to determine whether any of them are based on net income or earnings, Staff focused almost exclusively on the manner in which the program and its goals are administered for purposes of providing the incentive pay. Staff. Ex. 12.0, ll. 144-171.

MidAmerican states there is clear and uncontested evidence in the record of ratepayer benefits stemming from the MidAmerican PIP program. These benefits include high levels of customer satisfaction as well as cost containment and safety. See, e.g., MidAmerican Ex. MAG 2.1, Schs. A-C. MidAmerican recognizes that the Commission considers that cost management/cost control efforts benefit shareholders as well as ratepayers. Unlike cost control/management goals, goals relating to certain objectives such as customer satisfaction and rate stability accrue primarily to customers and not shareholders. Moreover, MidAmerican states, goals such as cost control and safety have substantial customer benefits.

MidAmerican highlights uncontested customer benefits that arose as a result of MidAmerican's implementation of incentive compensation since the program's initial implementation in 1997, including: long term rate stability, strong customer satisfaction, declining operations and maintenance expense, and a positive safety record. MidAmerican points out these accomplishments have occurred during a time when MidAmerican's overall compensation, including both base and incentive pay, has been reasonable, including an average of 96% PIP payouts from 2003-2013. MidAmerican Ex. MAG 3.0 at 6, ll. 128-130. MidAmerican also observes it is uncontested in this case that MidAmerican salaries are at market pay levels. In other words, to achieve these results, MidAmerican has paid no more than what it would have to pay its employees without placing any compensation at risk. Moreover, the Company argues that Staff offered no evidence to challenge customer benefits in the record, and that Staff's objection simply goes to PIP administration and a misunderstanding about its goals and objectives.

MidAmerican notes that Staff witness Mr. Bridal, while acknowledging that he has no reason to object to the allowable goals, recommended 100% disallowance of all incentive compensation solely because he could not determine the impact of the non-allowable goals. Tr. at 77, ll. 4-10.

MidAmerican contends its PIP compensation is not discretionary or subjective as Staff contends. MidAmerican points out Staff completely ignores that the six core principles drive every corporate and individual goal of MidAmerican and that many of the goals contain metrics. A few of these metrics include:

- reducing incident rates to a level equal to the top 10% of the industry peer group;
- achieving top 10% performance on overall customer satisfaction and overall satisfaction with electric reliability in all residential commercial and industrial customer satisfaction surveys;
- achieving customer and delivery service performance targets; and
- implementing a formal contractor safety incident tracking program.

MidAmerican maintains Staff misconstrues the discretionary aspect of MidAmerican's PIP. Where the PIP incentive is merely an element of a market-based compensation package, management's "discretion" regarding payout must be narrowly targeted if MidAmerican's compensation is to remain competitive. The fact that the payout has averaged 96% over the last eleven years strongly supports this conclusion. Staff Ex. 12.0, Att. B at 2.

MidAmerican argues that from the development of the corporate goals to the time of corporate and individual evaluation, incentive pay amounts are clearly and consistently based on annual accomplishments of goals based on the six core principles. The major difference between the approach of the PIP and an approach where a metric is a “trigger” for an award is the ability of the incentive award to be based on overall corporate performance for the year instead of some subset of performance. MidAmerican’s approach allows the President to use reasoned judgment regarding company performance, which allows balancing of accomplishments in each of the six areas against one another. There is no “absolute discretion” by the president. Instead, all of his decisions revolve around the goals which in turn revolve around the core principles.

MidAmerican acknowledges that part of Staff’s objection is to incentive awards based on a financial performance objective and that the Commission has generally disallowed financial goals finding them to primarily benefit shareholders. MidAmerican also recognizes that at the hearing Mr. Bridal limited his objection to those goals under the financial strength core principle that are of the incomes or profit-margin nature. Tr. at 70, ll. 16-20, and not all goals associated with its financial strength core principle. MidAmerican argues that financial strength is not the same as a financial performance objective. MidAmerican’s financial strength core principle is intended to ensure a company with adequate financial resources to meet customer requirements and should thus warrant consideration by the Commission as an appropriate part of allowable employee incentive compensation expense.

MidAmerican further argues that because it provides natural gas and electric service and is a multi-jurisdictional utility, many of the costs, expenses and revenues reflected in the revenue requirement must be allocated in order to get the proper jurisdictional amount. MidAmerican points out Staff did not express concern about MidAmerican’s allocation factors used to allocate costs between gas and electric and to different jurisdictions. Yet, in rebuttal testimony, Mr. Bridal suggests PIP expenses should be disallowed because certain corporate goals are not associated with Illinois utility service. Staff Ex. 12.0, ll. 112-122.

MidAmerican points out that, since the core principles apply to all MidAmerican operations and the PIP measures performance of the entire company, there will be some goals that may not apply to all employee groups yet are important to overall company operations. MidAmerican argues that this does not mean that costs unassociated with Illinois are being charged to Illinois customers. In fact, MidAmerican’s proposed Illinois electric rates include only a relatively small portion of total incentive compensation. The total of incentive compensation pay is charged to jurisdictions based on a system of allocations based on the FERC and Commission systems of accounts that ensures appropriate costs will be charged to each jurisdiction. Moreover, it should be noted that the mix of goals related to specific jurisdictions is likely to change from year-to-year based on changing relative circumstances between jurisdictions.

Staff's Position

Staff proposes an adjustment to disallow 100% of PIP incentive compensation costs and associated payroll tax and pension costs. According to Staff, the PIP incentive compensation costs are: (1) subjective or discretionary in nature; (2) based partially on the financial performance of the Company; (3) based on goals that have no direct payout percentages assigned; and (4) based on various goals which are not associated with Illinois electric jurisdictional utility service. Staff Ex. 12.0 at 3. Staff states it is unknown what impact the achievement of or failure to achieve each of the overall company goals and individual employee goals has on the final PIP incentive compensation costs. *Id*. at 5. Due to these factors, the degree to which PIP incentive compensation costs are associated with specific dollar savings or other tangible benefits for ratepayers, or associated with Illinois electric jurisdictional utility service, cannot be determined. *Id*. Staff further argues that payroll taxes and pension costs associated with PIP incentive compensation are derivative costs that would not have been incurred absent the non-allowable PIP incentive compensation. Staff Ex. 3.0 at 22-25; Staff Ex. 12.0 at 12-14. Thus, Staff concludes that PIP incentive compensation costs and associated payroll tax and pension costs must be removed from the MidAmerican revenue requirement.

According to Staff, Commission practice with regards to rate recovery of incentive compensation is clear: incentive compensation costs based on financial performance or other financial metrics that primarily benefit shareholders are not allowable. Staff points out that the Commission has on several occasions disallowed incentive compensation costs that are based on financial performance. Some recent examples of the Commission's disallowance of incentive compensation dependent on financial performance are *Ameren Illinois Co*., ICC Order Docket No. 07-0585 – 07-0590 (cons.), 106-108 (September 24, 2008), and *Northern Illinois Gas Co*., ICC Order Docket No. 08-0363, 28 (March 25, 2009), where the Commission disallowed incentive compensation based on financial targets that primarily benefitted shareholders. Staff Ex. 3.0 at 21-22. Staff states that MEC's PIP incentive compensation award is determined in part using non-allowable financial goals and goals that are not related to the provision of Illinois electric jurisdictional utility service. Staff Ex. 12.0 at 6-8. To the extent that non-allowable metrics contribute to incentive compensation costs, Staff contends, the associated incentive compensation costs must be removed from the revenue requirement.

Staff further states that the Commission has also been clear regarding the need for the assignment of direct payout percentages/weightings to incentive compensation goals. In the absence of transparent assignments, Staff argues it is not possible for the Commission to determine what portion of an award is related to a utility's operational performance and what weights were given to metrics of a non-allowable financial or non-jurisdictional nature. Staff Ex. 12.0 at 10-11.

Staff points out that MEC argues that the PIP incentive compensation plan does not include an improper or excessive degree of subjectivity or discretion because it was carefully designed and implemented to reflect sound judgment misses the point. MEC Ex. MAG 3.0 at 3. MEC also argues that while some of the PIP incentive compensation goals lend themselves to quantifiable metrics, others do not, and as such sound business judgment needs to be applied in assessment of those goals. *Id*. at 2. Staff argues that MEC misses the point. According to Staff, the issue is not the manner in which the PIP incentive compensation plan was designed and implemented, nor is it the Company's assessment of the individual goals. Rather, MidAmerican employs no transparent or objective metrics, policies, procedures, or guidelines to determine how each goal is weighted in determining the overall PIP incentive compensation award. Staff Ex. 12.0 at 6-7. As such, Staff argues it is unknown what impact the achievement or failure to achieve each of the overall company goals and individual employee goals has on the final PIP incentive compensation costs. Staff Ex. 12.0 at 5. Staff maintains that the Company has not demonstrated that the actual 2012 PIP incentive compensation award was related to the claimed bases; therefore, the costs of PIP incentive compensation should not be recovered in rates. *Id*.

Commission Analysis & Conclusion

The Commission allows a company to recover costs related to incentive compensation expenses if those costs provided tangible benefits to ratepayers. Incentive compensation costs based on financial performance that primarily benefits shareholders are not recoverable.

There is no dispute that many of MidAmerican's goals primarily benefited ratepayers and MidAmerican provided sufficient evidence that ratepayers received tangible benefits. Accordingly, the incentive compensation costs associated with those goals should be recoverable by MidAmerican. However, Staff provided evidence supporting a finding that at least some of the PIP incentive compensation costs should not be recovered. Thus, the Commission must determine what amount, in any, MidAmerican should recover of its overall PIP compensation costs. The problem, as Staff points out, is that there is no discernible way to determine what portion of the overall incentive compensation costs is related to the goals that primarily benefited ratepayers versus the goals that Staff objects to on financial performance or jurisdictional grounds.

MidAmerican does not appear to fully disagree with Staff's assessment that a few of the goals may relate to non-recoverable financial performance costs. However, MidAmerican would have the Commission overlook these non-recoverable incentive compensation costs on the basis that incentive compensation is centered on the Company's six core principles and that the Company pays out an average of 96% of its incentive compensation per year regardless of the Company's overall corporate performance. We decline to make such a finding. MidAmerican did not provide any evidence assigning percentages or some type of metrics to the 39 PIP incentive compensation goals, therefore the Commission cannot determine what portions of the incentive compensation costs is properly recoverable by the Company.

MidAmerican argues in the alternative that, if the Commission finds disallowance of incentive compensation is required, the Commission should award a pro rata share of incentive compensation based on equal weighting of each of the 39 PIP incentive compensation goals. MidAmerican suggests that for each goal the Commission finds not recoverable, the Commission should disallow 1/39th of the PIP incentive compensation. However, MidAmerican admits that the mix of goals changes from year to year at the very least on a jurisdictional level. This is indicia that different weights are given to different goals in any given year, thus contravening any assignment of an equal ratio between the goals. The Commission finds that there is insufficient evidence to determine what portions of the incentive compensation plan may be recovered. Accordingly, the Commission adopts Staff's adjustment to disallow 100% of MidAmerican's PIP incentive compensation.

2. Steam Production Maintenance

MidAmerican's Position

MidAmerican proposed an adjustment to normalize maintenance costs for MidAmerican's coal units by adjusting test year values to five-year average values. Maintenance costs for MidAmerican's coal generation facilities can vary significantly from year to year depending upon where each of the units is with respect to its major maintenance cycle and the extensiveness of the maintenance performed. Five years was selected as the normalization period since these units are generally on a five-year cycle for major overhaul work. MidAmerican Ex. RRT 1.0 at 7, ll. 125-131.

MidAmerican included an inflation factor because a five year average of actual costs only reflects changes in the level or work activity, but the five year average ignores changes in cost levels for the work being performed over that period of time. MidAmerican Ex. RRT 1.0 at 7. Therefore, MidAmerican relied on the Handy-Whitman index in its calculations of these costs. Since the calculation was an average, the change in the index over the five years was averaged as well. *Id*.

MidAmerican and Staff agree that normalizing steam production maintenance costs is appropriate and reasonable. MidAmerican Ex. RRT. 2.0 at 4, ll. 60-61; Staff Ex. 3.0 at 5. MidAmerican accepted Staff's adjustments regarding the application of the inflation factors to normalize these costs. MidAmerican Ex. RRT 2.0 at 3-4, ll. 40-47.

MidAmerican agreed with DoD's position that there is an element of duplication with the adjustments for steam production maintenance for labor and the payroll pro forma adjustment to the extent of the labor costs that are embedded in steam production maintenance. Accordingly, MidAmerican proposed a modification to the payroll tax adjustment to remove any escalation associated with payroll charged to steam production maintenance. MidAmerican Ex. RRT 2.0 at 7. Staff agreed with MidAmerican's adjustment. Staff Ex. 12 at 2, 18-19.

DoD, however, continues to recommend the Commission reject the normalization of steam production costs. MidAmerican argues that DoD fails to consider that the normalization of costs has been a long-accepted practice by the Commission and is relevant for the types of costs that are volatile from year-to-year, as is the case with steam production and distribution maintenance costs. MidAmerican contends its proposed methodology to normalize these costs, as adjusted by Staff, is a reasonable approach to achieve such normalization for steam production costs.

Staff's Position

Staff proposes an adjustment to the operating statement that amends the Company's pro-forma adjustment to steam production maintenance expense. Staff's adjustment updates the Company's five-year normalization period to include the most recent 2013 expense information and amends the application of the Company's proposed inflation factor. Staff Ex. 3.0 at 3-4. Staff states that, compared to the 2012 steam production maintenance expense incurred by MEC, the normalized steam production maintenance expense amount set forth by Staff is more representative of the actual level of expense expected during the years in which proposed rates will be in effect. Staff Ex. 12.0 at 18-19. In the interest of narrowing issues in this case, MEC accepted Staff's adjustment. MidAmerican Ex. RRT 2.0 at 3-4.

Staff argues that the Commission should reject the DoD's arguments regarding this issue, with the exception of the double counting of internal payroll dollars. MEC modified its pro forma payroll adjustment to address the DoD's double counting concerns in rebuttal testimony, and Staff states that the amended pro forma payroll adjustment should be accepted. Staff Ex. 12.0 at 14-15.

DoD maintains in rebuttal testimony its opposition to normalizing steam production maintenance expense. DoD/FEA Ex. GRM 4.0 at 2-8. Using MEC total company numbers rather than Illinois jurisdictional amounts, DoD again argues that internal labor should be removed from the normalization calculation. However, Staff agrees with MEC that Illinois electric jurisdictional amounts should be used in this assessment – not total Company amounts. MidAmerican Ex. RRT 3.0 at 6-7; Staff Initial Brief at 28. DoD further opposes normalization of steam production maintenance expense claiming that adjusting test year steam production maintenance expense in isolation of total production maintenance expense is misleading. DoD/FEA Ex. GRM 4.0 at 7. MEC states that the inclusion of other production maintenance costs is inappropriate because growth in other production maintenance costs has been driven by wind-powered generation, and that the significant majority of those costs are not assigned to Illinois, making other production costs a non-factor in this case. MidAmerican Ex. RRT 3.0 at 7. Staff argues that non jurisdictional costs should not be used to assess the propriety of the normalization adjustment.

DoD's Position

DoD presented the testimony of Mr. Greg R. Meyer to address its concerns regarding steam production maintenance. Mr. Meyer testified that MidAmerican overstated the normalized level of steam production maintenance expense. DoD/FEA Ex. 2.0 at 10. According to Mr. Meyer, internal labor dollars are being annualized twice, and the Company's adjustment in rebuttal testimony does fully eliminate the problem. DoD/FEA Ex. GRM 4.0 at 6-8.

Mr. Meyer further testified that the allocation of expenses for steam production maintenance allocated to Illinois has declined during the five year period, and MidAmerican failed to consider that change in allocations to Illinois for normalizing this expense. DoD/FEA GRM 2.0 at 11. Also, Mr. Meyer stated the levels of Total Company steam production maintenance expense has fluctuated. *Id.* According to Mr. Meyer, these fluctuating levels of expense can be attributed to different levels of production maintenance incurred on the generators. *Id.* Mr. Meyer believed that the Company failed to demonstrate that inflation has also impacted these operations. *Id.* Mr. Meyer stated that MidAmerican did not consider any productivity or technological improvements in the maintenance processes that would offset the effects of inflation. Mr. Meyer argued that, by granting inflation adjustments, utilities will have less incentive to effectively control costs. *Id.* Finally, Mr. Meyer testified that he does not believe Section 285 filing requirements contemplates using an inflation adjustment with a historic test year. *Id.*

Commission Analysis & Conclusion

The Commission does not find DoD's arguments against MidAmerican's proposed adjustment to normalize maintenance costs persuasive. Mr. Meyer improperly relies on total Company amounts rather than Illinois electric jurisdictional amounts in his assessment. Moreover, the proposed modified adjustment, as supported by MidAmerican and Staff, is consistent with the Commission's traditional treatment of such costs. Mr. Meyer did not provide sufficient evidence to alter the Commission's traditional treatment of the normalization of these types of costs. Accordingly, the Commission adopts MidAmerican's steam production maintenance costs, as adjusted by Staff.

3. Distribution Maintenance

MidAmerican's Position

MidAmerican proposed an adjustment to normalize maintenance costs for MidAmerican's electric distribution system by adjusting test year values to five-year average values. Distribution costs can vary significantly from year to year due to the occurrence of storms, flooding or other unpredictable circumstances. A multi-year average of such costs smoothes the impact of such occurrences. Five years was used to be consistent with the approach used with steam maintenance. A distribution plant inflation index was used in the calculation for the same reasons outlined above for steam maintenance. MidAmerican Ex. RRT 2.0 at 8.

MidAmerican included an inflation factor because a five year average of actual costs only reflects changes in the level or work activity, but the five year ignores changes in cost levels for the work being performed over that period of time. MidAmerican Ex. RRT 1.0 at 7. Therefore, MidAmerican relied on the Handy-Whitman index in its calculations of these costs. Since the calculation was an average, the change in the index over the five years was averaged as well. *Id*.

MidAmerican and Staff agree that normalizing distribution maintenance costs is appropriate and reasonable. MidAmerican Ex. RRT. 2.0 at 4; Staff Ex. 3.0 at 5. MidAmerican accepted Staff's adjustments regarding the normalization of these costs. MidAmerican Ex. RRT 2.0 at 3-4.

MidAmerican agreed with DoD's position that there is an element of duplication with the adjustments for distribution maintenance labor and the payroll pro forma adjustment to the extent of the labor costs that are embedded in distribution maintenance costs. Accordingly, MidAmerican proposed a modification to the payroll tax adjustment to remove any escalation associated with payroll charged to distribution maintenance. MidAmerican Ex. RRT 2.0 at 7. Staff agreed with MidAmerican's adjustment. Staff Ex. 12 at 2, 14-16.

DoD, however, continues to recommend the Commission reject the normalization of distribution maintenance costs. MidAmerican contends DOD's position fails to consider that the normalization of costs has been a long-accepted practice by the Commission and is relevant for the types of costs that are volatile from year-to-year, as is the case with distribution maintenance costs. MidAmerican argues its methodology to normalize these costs proposed by MidAmerican, as adjusted by Staff, is a reasonable approach to achieve such normalization for distribution maintenance costs.

Staff's Position

Staff argues the Commission should adopt Staff's adjustment to the operating statement to amend the Company's pro-forma adjustment to distribution maintenance expense. Staff's adjustment to distribution maintenance expense updates the Company's five-year normalization period to include the most recent 2013 expense information, and amends the application of the Company's proposed inflation factor. Staff Ex. 3.0 at 4-5. Compared to the 2012 distribution maintenance expense incurred by MEC, the normalized distribution maintenance expense amount set forth by Staff is more representative of the actual level of expense expected during the years in which proposed rates will be in effect. Staff Ex. 12.0 at 16-18. In the interest of narrowing issues in this case, MEC accepted Staff's adjustment. MidAmerican Ex. RRT 2.0 at 3-4.

As with the steam production maintenance expenses addressed supra, Staff argues that the Commission should reject the DoD's same arguments regarding this issue, with the exception of the double counting of internal payroll dollars. MEC modified its pro forma payroll adjustment to address the DoD's double counting concerns in rebuttal testimony, and Staff states that the amended pro forma payroll adjustment should be accepted. Staff Ex. 12.0 at 14-15.

Staff states it is unclear how the proportion of MEC Illinois jurisdictional distribution maintenance expense to MEC total distribution maintenance expense referenced by DoD has any impact on the propriety of the normalization adjustment. In

Staff's view, it is equally unclear how the customer change numbers referenced by DoD impact the normalization adjustment's propriety. Staff Ex. 12.0 at 15. Regarding the fluctuation of distribution maintenance expense, Staff argues that these fluctuations are precisely why normalization is appropriate. The large variances noted among years during the 2008-2012 period and extending through the 2013 year support the need to normalize (i.e., average) distribution maintenance expense. *Id*. at 16. Finally, regarding the use of inflation factors in the normalization adjustment, in this instance an inflation factor is not used to simply increase test year costs. Here an inflation factor is applied to restate each applicable historical year cost in terms of 2013 dollars, which is consistent with past Commission practice. *Id*. at 17-18.

DoD's Position

DoD witness Mr. Meyer objects to MidAmerican's proposed adjustment to normalize distribution maintenance expense. Mr. Meyer testified that he believes MidAmerican overstated the normalized maintenance expense and proposes that the $2.2 million adjustment be disallowed. DoD/FEA Ex. GRM 2.0 at 2-3. Mr. Meyer stated that MidAmerican's adjustment to distribution maintenance expense includes a five-year average of the expenses from 2008-2012, which is increased to include inflation. *Id.* at 3. Mr. Meyer stated that the distribution maintenance total includes internal labor dollars that are already included in the labor adjustment, and therefore are being adjusted twice in the inflation component. *Id.* According to Mr. Meyer, MidAmerican's proposed adjustment to address double-counting internal labor does not fully eliminate the effects of internal labor in the Company's distribution maintenance adjustment. DoD/FEA Ex. GRM 4.0 at 3.

Mr. Meyer further testified that the level of allocation of distribution maintenance expense to the Illinois jurisdiction is decreasing. According to Mr. Meyer, customer growth is slower in Illinois than either Iowa or South Dakota, two other states in which MidAmerican operates. Mr. Meyer argues that, "Since the growth in customers, and thus meters, is less in Illinois than in the other two jurisdiction of MidAmerican, it would be improper to not consider that growth in those jurisdictions which adjusting distribution maintenance expense." DoD/FEA Ex. GRM 2.0 at 6.

Mr. Meyer testified that MidAmerican should have broken down the components of expense for each of the five years and shown the increased costs per component to maintain the distribution plant to validate that inflation is the cost driver for these expenses. *Id.* Furthermore, Mr. Meyer believed that if a utility is given inflationary increases in expense, the utility has less incentive to control costs. *Id.* at 7. Mr. Meyer also stated that MidAmerican failed to provide justification as to why the Handy-Whitman Index should be used to predict possible inflationary trends.

Commission Analysis & Conclusion

The DoD's objections to MidAmerican's proposed adjustment to normalize distribution maintenance expense are the same as its objections to MidAmerican's steam maintenance expense adjustment. As noted supra, Mr. Meyer improperly relies on total Company amounts rather than Illinois electric jurisdictional amounts in his assessment. The proposed modified adjustment, as supported by MidAmerican and Staff, is consistent with the Commission's traditional treatment of such costs, and is hereby adopted.

4. State Income Tax Rate

MidAmerican's Position

In rebuttal testimony, Staff presented an adjustment to reflect what Staff characterizes as a known and measureable change in the Illinois corporate income tax rate, effective January 1, 2015. Staff Ex. 10.0 at 5, ll. 87-89.

While MidAmerican provided this adjustment as requested by Staff in rebuttal testimony, MidAmerican contended the Commission should reject this adjustment for several reasons. First, MidAmerican observed the Illinois state income tax change is not a known and measurable change because it occurs outside the twelve month period from date of filing that is generally accepted as the timeframe to quantify known and measurable changes to test year data. MidAmerican Ex. RRT 3.0 at 3. MidAmerican's tariffs were filed on December 16, 2013. If the Commission reaches out beyond this twelve month period, as suggested by Staff, it is necessary for the Commission to also reach out beyond such period to quantify additional pro forma adjustments, including contractually scheduled pay rate increases for union employees, contractually scheduled escalations for coal transportation costs that begin beyond 2014, or additions to rate base to be placed in service beyond 2014 to be consistent and match all revenues with expenses. *Id*.

Moreover, MidAmerican argues that, as a procedural matter, Staff's adjustment raises an issue not addressed in direct testimony by any witness, and it is not appropriate to raise new issues on rebuttal. *Id*.

Third, MidAmerican argues that Staff's proposed change is not known. The Illinois General Assembly considered a proposal to delay the scheduled drop in the tax rate in its latest session, but that proposal was rejected. Given the current budgetary situation of the State of Illinois, it is not unreasonable to expect such a proposal to be raised again in the fall session and pass prior to the scheduled effective date of the rate change. MidAmerican Ex. RRT 3.0 at 3-4.

Staff's Position

Staff witness Ms. Jones proposed an adjustment to reflect a known and measurable change in the Illinois corporate income tax rate ("SIT"), effective January 1, 2015. Staff states that, according to current State law, the corporate income tax rate will decrease to 5.25% from 7.0% on that date. Staff Ex. 10.0 at 5.

Staff argues that MEC errs in stating that Staff's proposed change to the state income tax rate to apply in the test year is not known and is unreasonable. MEC Initial

Brief at 45. Rather, in Staff's view, what is not known and what is unreasonable is MEC's proposal to approve rates based upon pure speculation as to what actions the General Assembly may take in the future regarding income tax rates. The 2015 state income tax rates have been known since January 2011, when the Illinois Legislature passed Senate Bill 2505, which raised the state income tax rate for individuals and corporations as of January 1, 2011, with a scheduled drop in the tax rate effective January 1, 2015. 35 ILCS 5/2-201. Staff argues that it is entirely unknown when the General Assembly will pass legislation to delay the scheduled drop in the rate, or if such legislation will be passed at all. While one may agree with MEC's argument that it is unreasonable to expect that such legislation will not be passed, Staff argues this does not mean it will happen. In Staff's view, the legislative process in Illinois is too unpredictable to assume a given outcome based upon MEC's optimism that the law will be changed before the new rates go into effect. Staff argues that the Commission is charged with approving just and reasonable rates in accordance with Illinois law, not what MEC hopes that the law will become.

The January 2015 effective state income tax rate is currently known and reflected in Staff's adjustment. Staff argues that it would be unjust and unreasonable for MEC to collect from ratepayers funds for income taxes that are not in accordance with the tax rates set forth in the Illinois Income Tax Act. 35 ILCS 5/2-201, *et. seq*. Staff maintains that its adjustment is in accordance with the Public Utilities Act regarding the Commission's determination of just and reasonable rates. 220 ILCS 5/9-101. The instant case will conclude in November, which is less than two months before the state income tax rate is scheduled to decrease by law. 35 ILCS 5/2-201(b)(12). In Staff's view, it is neither just nor reasonable for the Company to recover state income taxes from its customers at a higher rate than what it will be obligated to pay under current law, and accordingly, Staff's proposed adjustment should be adopted.

Commission Analysis & Conclusion

The Commission finds that the scheduled drop in the tax rate is a known and measurable change. The change in the tax rate is the current law, and was the current law during the test year of 2012. Moreover, MidAmerican's argument that the General Assembly may delay the scheduled drop in the tax rate is speculative. The Commission cannot make determinations on just and reasonable rates based on what the General Assembly may do in the future. Rather, the Commission must base its decisions on current law. The Commission agrees with Staff that there should be an adjustment for the change in the state income tax rate. Accordingly, the adjustment proposed by Staff to current and deferred taxes reflected in MidAmerican Exhibit RRT 3.2 is adopted.

5. Rate Case Expenses

MidAmerican's Position

MidAmerican opposes Staff's adjustment to disallow $70,000 of rate case expense related to the services of MidAmerican's outside return on equity witness. MidAmerican points out that Illinois law is clear that a utility is entitled to recover rate case expenses. The Illinois Supreme Court defines these expenses as ordinarily, properly and fairly allowable as an operating expense. *DuPage Util. Co. v. Illinois Commerce Comm'n*, 47 Ill. 2d 550, 553, 561 (1971) (holding that "just and reasonable" rates "should be sufficient to provide for operating expenses" and that "rate-case expense is ordinarily properly and fairly allowed as an operating expense").

MidAmerican argues the evidentiary record contains substantial evidence demonstrating that MidAmerican's revised proposed rate cases expenses relating to its outside witness are just and reasonable. Moreover, the record evidence is more than sufficient for the Commission to specifically assess the justness and reasonableness of those expenses as required by Section 9-229 of the Act, 220 ILCS 5/9-229.

MidAmerican presented evidence demonstrating that Dr. James Vander Weide provided expert analysis and testimony regarding the recommended return on equity for MidAmerican. MidAmerican also presented evidence that it does not have an employee who is a cost of capital expert. MidAmerican Ex. DLK 2.0 at 7; and MidAmerican Ex. DAC 2.0 at 3. MidAmerican explained that the expertise required is very specialized, often necessitating an advanced college degree; and the frequency in which the expertise is needed has not justified having an employee with this skill set on staff. *Id.*, MidAmerican Ex. DAC 2.0, ll. 23-28. Mr. Crist testified that from his thirty-six years of experience, he believes it is the norm for utilities to retain such expertise for rate cases on an as needed basis from an outside expert. MidAmerican Ex. DAC 1.0 at 2; DAC 2.0 at 3.

MidAmerican points out that Mr. Kahle also agreed on cross examination that it is typical for utilities to engage an outside witness for ROE issues and also acknowledged that Dr. Vander Weide's work was not duplicated by MidAmerican personnel. Tr. at 62, ll. 4-12.

MidAmerican argues that the Company and Dr. Vander Weide have a written contract as shown in Staff Ex. 5.0, Att. A. MidAmerican states the engagement letter clearly defines the scope of work in the paragraph entitled Work. The contract defines the fee and specifies the dollar per hour for services and reimbursement of expenses. While this agreement was orally amended to expand the scope for the Illinois rate case, MidAmerican states that there is, none the less, a written contract. MidAmerican argues that the contract does not require that any changes to the agreement must be in writing.

MidAmerican argues it demonstrated that the amendment to include Illinois return on equity testimony was not significant enough to change the either MidAmerican's obligations or Dr. Vander Weide's obligations under the engagement letter. The performance for the Illinois rate case was identical to the performance for the Iowa cases. Additionally, according to MidAmerican, there is no issue that the contract clearly defines the scope of work and the fee and specifies the dollar per hour for services and reimbursement of expenses. MidAmerican expected and has paid for his services in accordance with the rates specified in that agreement. Mr. Kahle confirmed that the services performed by Dr. Vander Weide were consistent with the terms set forth in the engagement letter. Tr. at 64-65.

MidAmerican maintains the oral amendment to the engagement letter is consistent with Illinois law and the work performed was also consistent with the engagement letter. Furthermore, Section 9-229 does not require that the Commission review include review of a specific contract or engagement to make its determination.

MidAmerican maintains relevance of whether an engagement letter was expanded by verbal agreement or by written agreement does not change the fact that MidAmerican presented evidence regarding the nature of the services, the time expended and the hourly rate charged. All of these factors were consistent with the engagement letter. Moreover, given the multiple rate cases in different jurisdictions, MidAmerican was able to create efficiencies by engaging the same witness to perform services for rate cases filed within the same year but in different jurisdictions.

Staff's Position

Staff proposes to disallow $70,000 of rate case expense related to the services of an outside witness. According to Staff, the MidAmerican did not provide support that the services of the outside witness were just and reasonable. Staff argues that entering into a contractual agreement without specifying the scope and cost of the engagement in writing does not allow the Commission to determine if the costs incurred are reasonable and necessary. In Staff's view, orally amending a contract for $70,000 is not a reasonable practice, and the Commission should not permit the Company to recover these costs. MidAmerican Ex. DLK 1.0 at 5-6.

Staff argues that, without a written contract, the Commission cannot assume that the terms of this outside witness' engagement agree with the services provided or that the outside witness' billings were reasonable or justified. Section 9-229 of the Act requires the Commission to review the Company's requested rate case expense. In Staff's opinion, the Commission should not accept the Company's unsupported assertion that someone at the Company orally authorized a contract amendment, without troubling to memorialize it. Staff argues that this is unreasonable and must be rejected.

Commission Analysis & Conclusion

Staff proposes to disallow $70,000 of rate case expense related to MidAmerican's return on equity witness Dr. Vander Weide. After reviewing the record evidence regarding the Company's rate case expense, the Commission finds that MidAmerican's rate case expense related to Dr. Vander Weide is just and reasonable.

Section 9-229 of the Public Utilities Act, 220 ILCS 5/9-229, provides that:

> The Commission shall specifically assess the justness and reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare and litigate a general rate case filing. This issue shall be expressly addressed in the Commission's final order.

Utilities may recover costs incurred to prepare and present a rate case. *Illinois-American Water*, 2011 IL App (1st) 101776 at ¶ 13. To recover rate case expense, the Commission must determine that those costs are just and reasonable. See e.g. *Northern Illinois Gas Co.*, ICC Docket No. 04-0779 (Order Sept. 20, 2005) at 51. In a determination of whether rate case expense is just and reasonable, the utility must provide detailed information concerning current and expected expenses, the persons responsible for those expenses, and the specific purpose of those expenses. See *In re Charmar Water Co., et al.*, ICC Docket Nos. 11-0561/11-0566 (consol.) (Order May 22, 2012) at 19; *In re Charmar Water Co., et al.*, ICC Docket Nos. 11-0561/11-0566 (consol.) (Order on Rehearing Nov. 28, 2012) at 14.

Staff's argument that the Commission cannot determine the just and reasonableness of the disputed rate case expense because there is no written contract, and that any written contract must also contain a clause regarding the maximum allowed amount, is incorrect. While a written contract rather than an oral contract based on a prior business relationship would be evidence to support a determination of just and reasonableness, it is not required. MidAmerican must provide sufficient evident for a determination that its expenses were just and reasonable, and a written contract would be one type of evidence that MidAmerican could present to support its expenses.

MidAmerican presented evidence showing the overall time Dr. Vander Weide expended on the case and his hourly charge. MidAmerican presented evidence demonstrating the need and reasonableness of hiring an outside expert witness for the return on equity issue. MidAmerican supplied an engagement letter that the Company used for retaining the services of Dr. Vander Weide in a similar capacity as a return on equity witness in an Iowa proceeding. This engagement letter defines the scope, fee and services of the witness for which the oral amendment to provide the same services in this proceeding was based. Moreover, the fact that Dr. Vander Weide charged the same hourly rate for comparable work in another state only supports a finding that the hourly rate charged is consistent with market rates for the type of expert testimony. The engagement letter also contains a cursory explanation of the scope of work that Dr. Vander Weide would perform.

While Staff objects to the rate case expense for Dr. Vander Weide because there is no written contract, Staff does not dispute the overall charge of $70,000 or that the hourly rate was not within market rates for providing such services. After reviewing the documents provided by the Company for rate case expense, which included invoices, Staff did not suggest any adjustment. Staff Ex. 6.0 at 16-17.

While MidAmerican did not supply a more detailed description of the services provided by Dr. Vander Weide in this proceeding, his work product is evident both in his testimony and work papers. The Company also did not produce record evidence of the time and services provided by its expert witness on a daily basis. Should the rules regarding rate case expense that are pending in Docket 11-0711 not be in effect at the time of MidAmerican's next rate case filing, the Commission directs MidAmerican to provide such information. Nevertheless, the Commission finds that there is sufficient evidence that the total amount of $181,000, including the $70,000 for the outside expert witness, of rate case expenses are just and reasonable and should be included in the revenue requirement and amortized over five years resulting in a test year expense of $36,200.

VI. COST OF CAPITAL AND RATE OF RETURN

A. Overview

MidAmerican, Staff and DoD agree upon most of the components of MidAmerican's rate of return. MidAmerican's proposed capital structure and the amount of the Company's long-term debt are not in dispute. Disagreement, however, remains regarding the authorized rate of return on common equity ("ROE").

MidAmerican proposes a rate of return on rate base of 7.721% based upon a capital structure consisting of 48.270% long term debt at a cost of 4.528%, and 51.730% common equity at a cost of 10.70%. MidAmerican Ex. JHV 1.0 at 5, ll.71-74, MidAmerican Sch. D-1.

Staff proposes a rate of return on rate base of 7.14% based upon a capital structure and cost of debt presented by MidAmerican, but recommends the cost of common equity be set at 9.56%. Staff Ex. 6.0 at 33, ll. 662-665, Sch. 6.01.

DoD proposes a rate of return on rate base of 6.98% based upon a capital structure and cost of debt of 4.39%, and recommends the cost of common equity be set at 9.40%. DoD/FEA Ex. MPG 1.0 at 9, ll. 191-193, DOD/FEA Ex. MPG 1.1.

B. Capital Structure

MidAmerican presented a capital structure consisting of 48.270% long term debt and 51.730% common equity as of September 30, 2013. MidAmerican Sch. D-1, see also MidAmerican Ex. RRT 1.0 at 13, ll. 262-267. MidAmerican used September 30, 2013, to measure its capital structure for several reasons. First, capital transactions occurred in 2013 that impact the cost of capital, including a common dividend in January 2013, redemption of all outstanding preferred stock in April 2013 and issuance of long-term debt in September 2013 to, in large part, fund the December 2013 payment of deferred costs under a contract with Siemens that is accounted for as long-term debt. *Id*. at 14. Second, a fair amount of time has elapsed since the end of 2012 and the calculation as of September 30, 2013 reasonably updates the calculation with more current values. Id. Third, a number of rate base pro forma adjustments are included in MidAmerican's case, and an updated cost of capital more consistently matches the pro forma rate base. *Id*.

DoD and Staff agreed with MidAmerican's proposed capital structure. Staff Ex. 6.0 at 18, ll. 383-384; DoD/FEA Ex. MPG 1.0 at 9, ll. 191-193. Deere did not take a position on this issue.

Based on the evidence presented, the Commission finds MidAmerican capital structure reasonable.

C. Cost of Long-Term Debt

MidAmerican presented a calculation of the cost of long-term debt at September 30, 2013 that includes annual interest costs, amortization of long-term debt discount, issuance expense, annual amortization of gains and losses on reacquired debt, and the relative percentages of each component of long-term debt in MidAmerican's capital structure, arriving at a cost rate equal to 4.528%. MidAmerican Ex. RRT 1.0 at 15, ll. 295-299.

Staff agreed with MidAmerican's proposed cost of long term debt. Staff Ex. 6.0 at 18, ll. 383-384. DoD recommended a cost of long term debt of 4.39%, but did not support this amount in written testimony. DoD/FEA Ex. MPG 1.1; Staff Initial Brief at 34. As Staff observed, no party responded to DoD's cost of long term debt and it is unclear if the issue is contested. *Id*. Deere did not take a position on this issue.

The Commission finds that 4.53% is a reasonable estimate for MidAmerican's cost of long term debt. DoD failed to demonstrate that a different cost of debt should be used in this case.

D. Cost of Common Equity

MidAmerican, Staff and the DoD presented estimates of the Company's cost of common equity. MidAmerican proposes to use a ROE of 10.70%. Staff recommends a ROE of 9.56%. DoD supports a 9.40% cost of common equity.

1. MidAmerican's Position

MidAmerican witness Dr. Vander Weide used several generally accepted methods for estimating the cost of equity including the Discounted Cash Flow Method ("DCF"), the Capital Asset Pricing Model ("CAPM"), and the risk premium method. MidAmerican Ex. JHV 1.0 at 18, ll. 385-388. Dr. Vander Weide applied these methods to market data for a large group of utility companies of comparable risk. MidAmerican Ex. JHV at 3, ll. 41-43. Since the DCF, risk premium and CAPM require inputs that are not easily measured, the inputs must be estimated. *Id*. at 4, ll. 49-50. While this estimation can cause some degree of uncertainty surrounding the estimate of the cost of equity, the uncertainty in the estimate of the cost of equity for an individual company can be greatly reduced by applying cost of equity methods to a large sample of comparable companies. *Id*., ll. 51-53. A large sample allows the unusually high estimates for some individual companies to be offset by unusually low estimates for other individual companies. *Id*., ll. 54-55. Consequently, Dr. Vander Weide applied the cost of equity methods to large proxy groups of comparable electric companies. *Id*., ll. 51-53; at 25, ll. 561-566; ll. 586-587, and Sch. 1.

MidAmerican states that in utility regulation the current practice is to use the comparable company approach. This practice is supported by the United States

Supreme Court standard that the utility should be allowed to earn a return on its investment that is commensurate with returns being earned on other investments of the same risk. *Id*., ll. 57-61. These standards were set out by the United States Supreme Court in *Bluefield Water Works & Improvement Co. v. Public Service Comm'n of the State of West Virginia,* 262 U.S. 679 (1923) ("Bluefield") and *Federal Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591, 603 (1944) ("Hope") cases. Using the standards set in these two cases, MidAmerican recommends a cost of equity of 10.70%.

Proxy Group

Dr. Vander Weide used large groups of comparable risk electric utilities to apply to his cost of equity methodologies to reduce the uncertainty in the ROE estimate. Staff started with the same proxy group of 28 electric utilities Dr. Vander Weide used in his DCF method, but reduced its sample using two factors to screen Dr. Vander Weide's proxy group. Staff's screening eliminated 16 companies, reducing Staff's proxy group to just 12 comparable companies. Staff Ex. 6.0 at 20-22, ll. 428-475. DOD also used the same proxy group as Dr. Vander Weide, but eliminated one company, TECO, because it was involved in merger and acquisition activity. DoD/FEA Ex. MPG 1.0 at 10-11, ll. 220-230.

As noted above, the inputs in cost of equity methods are uncertain, and hence, must be estimated. To reduce the uncertainty in estimating the cost of equity, it is reasonable to apply cost of equity methods to a large sample of comparable risk companies. MidAmerican and DoD both use a large sample, but Staff, on the other hand, reduced its sample based Edison Electric Institute's ("EEI") data on the percent of regulated assets for each utility in 2012 and on Standard & Poor's bond ratings, ignoring other factors that may differentiate the risk of one electric utility from another, such as differences in generation mix, forecasted capital expenditures; age of generation, transmission and distribution assets; customer mix; population growth and density in the service area; expenditures required to meet new environmental-related regulation; economic health of the service territory; and state laws and regulations. MidAmerican Ex. JHV 2.0 at 3, ll. 48-53. MidAmerican contends that because Staff's data on percent regulated assets for 2012 and bond ratings do not reflect differences in the risk of investing in the equity of one utility compared to another, the Commission should rely on MidAmerican's larger proxy group to determine MidAmerican's cost of equity.

Additionally, MidAmerican argues there is no reasonable basis for Staff to eliminate electric utilities from that proxy group that are not within one notch of MidAmerican's 'A-' rating since bond rates related to the risk that a company will default on the payment of interest and principal on its bonds. MidAmerican Ex. JHV 2.0 at 8, ll. 178-179. Equity investors, on the other hand, are concerned with the variability in the return on their equity investment. *Id*. ll. 180-181. Consequently, equity risk is different from bond risk and bond ratings are a poor indicator of the risk of investing in a company's equity. *Id*., ll. 80-181. Indeed, as Dr. Vander Weide demonstrates, the average allowed return on equity for electric utilities is approximately the same regardless of the company's bond rating. MidAmerican Ex. JHV 3.0 at 7, ll. 126-134.

MidAmerican argues the Commission should recognize that Staff's recommendation is based on a small proxy group which creates uncertainty in Staff's recommended ROE estimate.

Flotation Cost Adjustment

Staff contends that MidAmerican's ROE recommendation is over estimated because it includes flotation costs and the Company has not established that any equity was issued during the test year. To support its contention, Staff notes that the Commission has rejected the use of flotation costs in some cases. However, MidAmerican notes that the Commission's decision in this case must be based on the record evidence and not the specific facts and findings in other dockets. 220 ILCS 5-10-103; 220 ICLS 5/10-201(e)(iv)(A).

MidAmerican explained that in this case it is reasonable to adjust the recommended ROE upward and allow the recovery of floatation costs over time as opposed to recovering them immediately as Staff suggests. Dr. Vander Weide explained that he included a 5%, or 23 basis points, allowance for flotation costs. MidAmerican Ex. JHV 1.0 at 24-25, ll. 537-557. This adjustment is reasonable because it reflects the market reality that all firms that have sold securities in the capital markets have incurred some level of flotation costs, including underwriters' commissions, legal fees, printing expense, etc. *Id*. at ll. 540-541. These costs are withheld from the proceeds of the stock sale or are paid separately, and must be recovered over the life of the equity issue. *Id*. In other words, these are real costs incurred and reflect the market conditions for equity issuances regardless of the timing of the issuance. Dr. Vander Weide used a 5% allowance for flotation costs because it is a conservative estimate representing market costs.

MidAmerican points out MidAmerican Ex. JHV 1.0, Appendix 3 includes further discussion and explanation regarding the reasonableness of reflecting flotation costs that Staff did not address. Although Staff is correct that flotation costs are incurred only at the time a firm issues new securities, there is no reason why an issuing firm ought to recover the expense only in the current period, i.e. the test year. MidAmerican Ex. JHV 1.0 at Appendix 3-4. In fact, if assets purchased with the proceeds of a security issue produce revenues over many years, it is reasonable to recognize flotation expenses over a reasonably lengthy period of time. This recognition is consistent with the generally accepted accounting principle that the time pattern of expenses match the time pattern of revenues, and it is also consistent with the normal treatment of debt flotation expenses in both regulated and unregulated industries. *Id*.

Moreover, MidAmerican contends recovering flotation costs is consistent with the Hope case criterion that a regulated company's revenues must be sufficient to allow the company an opportunity to recover all prudently incurred expenses, including the cost of capital. In doing so, the Commission is providing an incentive for investors to invest in the regulated company because flotation costs are an integral component of capital costs.

MidAmerican notes MidAmerican Ex. JHV 1.0, Appendix 3 sets forth various options for the ratemaking treatment of flotation costs and the most reasonable approaches are consistent with Dr. Vander Weide's inclusion of 23 basis points to the recommended ROE.

DCF Analysis

Dr. Vander Weide explained that the DCF model is based on the assumption that investors value an asset because they expect to receive a sequence of cash flows from owning the asset. Thus, investors value an investment in a bond because they expect to receive a sequence of semi-annual coupon payments over the life of the bond and a terminal payment equal to the bond's face value at the time the bond matures. Likewise, investors value an investment in a firm's stock because they expect to receive a sequence of dividend payments and, perhaps, expect to sell the stock at a higher price sometime in the future. MidAmerican Ex. JHV 1.0 at 18-19, ll. 402-409.

A second fundamental principle of the DCF method is that investors value a dollar received in the future less than a dollar received today. A future dollar is valued less than a current dollar because investors could invest a current dollar in an interest earning account and increase their wealth. This principle is called the time value of money.

Staff, MidAmerican and DoD all applied the quarterly DCF model in their respective ROE analysis. See generally, MidAmerican JHV 1.0 at 18-26, ll. 401-587; Staff Ex. 6.0 at 22, ll. 472-486; DoD/FEA Ex. MGP 1.0 at 12-16, ll. 258-346. MidAmerican points out DoD used two other DCF models, the multi-stage growth and the sustainable growth models. DoD's DCF result of 9.15% is derived by using the midpoint of both the average and median estimates of all three DCF models. DoD/FEA Ex. MPG 1.0 at 25, ll. 523-526. MidAmerican notes DoD concedes that the Commission's standard practice is to use the quarterly DCF model, although DoD disagrees with the Commission's standard practice. DoD/FEA Ex. 1.0 at 13, ll. 278-289. MidAmerican explained that both Staff and Dr. Vander Weide relied on the average DCF results for the comparable companies, whereas the DoD also relied on the median DCF results for the comparable companies. DoD's use of median results, in addition to average results, under estimates DoD's recommendation. MidAmerican argues it is reasonable for the Commission to reject both the DoD DCF results based on median values, and DoD's multi-stage and sustainable growth DCF results. The average DCF result for DoD's quarterly DCF model is 9.63%.

MidAmerican states its DCF recommendation is based on a large proxy group, a proxy group nearly identical to DoD's proxy group, and is based on inputs that are consistent with market data generally relied upon by investors. See generally MidAmerican JHV 1.0 at 18-26, ll. 401-587. Thus, in considering the impact of DCF results on the determination of an appropriate allowed ROE for MidAmerican, the Commission should rely on Dr. Vander Weide's 9.9% DCF result.

<u>CAPM Analysis</u>

MidAmerican notes that the CAPM is an equilibrium model in which the expected rate of return on an equity investment in a company is equal to a risk-free rate of interest, plus an expected risk premium, where the expected risk premium is the product of a company-specific risk factor, or beta, and the expected risk premium on the market portfolio of all securities. MidAmerican Ex. JHV 2.0 at 11, ll. 213-218. The fair rate of return standard requires that a company have an opportunity to earn its required return on its investment during the forward-looking period during which rates will be in effect. According to MidAmerican, because current interest rates are depressed as a result of the Federal Reserve's extraordinary efforts to keep interest rates low in order to stimulate the economy, current interest rates at this time are a poor indicator of expected future interest rates. *Id*. at 12, ll. 242-245. Economists project that future interest rates will be higher than current interest rates as the Federal Reserve allows interest rates to respond to market forces as the unemployment rate falls to normal levels. *Id*., ll. 245-248. Thus, MidAmerican concludes, the use of forecasted interest rates is consistent with the fair rate of return standard, whereas the use of current interest rates at this time is not. *Id*., ll. 248-249.

Dr. Vander Weide considered these factors to determine what risk free rate and company specific beta to input into the CAPM. Staff on the other hand did not take these factors into consideration. As a result, MidAmerican argues that Staff's CAPM recommendation should be rejected because it ignores the recent extraordinary efforts of the Federal Reserve to keep interest rates low and do not reflect MidAmerican's opportunity to earn its required return on its investment during the forward-looking period during which rates will be in effect. If Staff had employed a forward looking risk free rate based on the forecasted yield on long-term Treasury Bonds of 5.17%, then Staff's CAPM analysis would have produced a cost of equity of 10.10%. MidAmerican argues that, if Staff also attempted to reduce the uncertainty in its estimate, then Staff should have relied on a larger proxy group. MidAmerican Ex. JHV 2.0 at 13, ll. 262-271. MidAmerican points out, if Staff used the 28 company proxy group, then Staff's utility beta would have been 0.73, and using the appropriate risk free of 5.17% would have yielded a CAPM result of 10.50%. MidAmerican Ex. JHV 2.0 at 14-15, ll. 274-301.

MidAmerican notes that Staff's adjusted CAPM results are within the range of the historical and DCF-based CAPM results of 10.30% and 10.70% developed by Dr. Vander Weide. Although Dr. Vander Weide has presented evidence the CAPM tends to underestimate the cost of equity for companies whose equity beta is less than 1.0, MidAmerican recognizes that the Commission has traditionally relied on the results of the CAPM model. See generally MidAmerican Ex. JHV 1.0 at 38-43. Therefore, it is reasonable for the Commission to consider a CAPM range of 10.10% to 10.60%, which includes Staff's adjusted CAPM range of results of 10.10% to 10.50% and Dr. Vander Weide's average CAPM result of 10.60%. MidAmerican Ex. JHV 1.0 at 44; MidAmerican Ex. JHV 2.0 at 13 and 15.

MidAmerican notes that it is reasonable for the Commission to disregard DoD's CAPM result since the DoD acknowledges that its analysis is "conservative" and employs a risk free rate much lower than Value Line and the Energy Information Administration's forecasted risk free rate of 5.17%. MidAmerican Ex. JHV 2.0 at 27, ll. 567-577. Furthermore, DoD's CAPM recommendation does not take into consideration that the CAPM underestimates the cost of equity for companies with betas less than 1.0, and hence underestimates MidAmerican's cost of equity.

MidAmerican presented evidence outlining the weaknesses of the CAPM model. Staff took issue with Dr. Vander Weide's criticism that the CAPM underestimates the cost of common equity. Staff Init. Br. at 54. Staff argues that Dr. Vander Weide's explanation of how the Fama and French articles support his conclusion contains several flaws. Specifically, Staff claims that the explanation is based on: (1) a single observation from the Fama and French regression analysis; (2) market returns that represent only returns on large company stocks; (3) average realized one-year returns rather than expected returns; and (4) an average Treasury bill rate rather than an average Treasury bond rate. Staff Initial Brief at 55 and Staff Ex. l5.0 at 11-12.

MidAmerican counters Staff mischaracterized Dr. Vander Weide's testimony and failed to recognize that the CAPM is "theoretical and has its own limitations." North Shore-People's 2009 Rate Case at 123. MidAmerican argues Dr. Vander Weide has identified the CAPM's limitations and noted that these "limitations require that [the Commission] consult general financial market information to ensure that the model results presented . . . are generally consistent with real world conditions, and to guide [the Commission] determination of reasonable rates of return on equity based on the models that [the Commission] deem[s] appropriate for . . . consideration." *Id*.

MidAmerican contends Staff's criticisms of the Fama and French articles to support the conclusion that the CAPM underestimates the cost of equities for companies with betas less than 1.0 is misplaced. Although Dr. Vander Weide used a single observation from the Fama and French regression analysis in his response to Staff's data request, Staff fails to address the fact that Dr. Vander Weide's single observation has a beta value that most closely approximates the current average beta value for electric utilities and that, as a result, the observation is the most relevant one for testing whether Dr. Vander Weide's conclusion holds for electric utilities. MidAmerican Ex. JHV 3.0 at 12. Moreover, Staff also fails to recognize that the same conclusion would be reached if Dr. Vander Weide had used any observation with a beta value less than 1.0. *Id*.

MidAmerican argues Staff's claim that the market return in the Fama and French regression analysis only represents the returns on large company stocks is incorrect. *Id*. at ll. 259-261. The 2004 Fama and French article clearly states that the authors estimate the market return by calculating a weighted average of the market return on all New York Stock Exchange (NYSE), American Stock Exchange (AMEX), and National Association of Securities Dealers (NASDAQ) stocks in the Center for Research in Security Prices (CRSP) database.

MidAmerican contends Staff's claim that the Fama and French regression analysis relies on realized one-year returns is also incorrect. MidAmerican argues that the 2004 Fama and French article also clearly states that their study is based on two to five years of returns. Furthermore, MidAmerican argues Staff fails to note that virtually all published tests of the CAPM rely on realized returns because it is only realized returns that are observable. *Id*. at ll. 286-291.

Staff claims that the Fama French regression analysis does not apply to Staff's CAPM analysis because the Fama French regression is based on an average Treasury bill rate, whereas Staff's analysis is based on an average Treasury bond rate. MidAmerican counters that Staff fails to recognize that the conclusion that the CAPM underestimates the cost of equity for companies with betas less than 1.0 continues to hold when long-term interest rates are used to estimate the risk-free rate component of the CAPM. *Id*. at ll. 292-295.

Finally, Staff contends that the Fama and French article was contradicted by more rigorous studies of the CAPM. Staff Initial Brief at 56. MidAmerican, however, points out Staff does not provide any specific examples of the "more rigorous studies" that contradict the Fama and French results.

MidAmerican notes the CAPM has its limitations and the Commission must recognize these theoretical limitations and consult general financial market information to ensure that the model results presented are generally consistent with real world conditions. MidAmerican presented evidence that if Staff's CAPM analysis recognized these limitations, Staff's CAPM would have yielded a range of 10.10%, employing a forecasted risk-free rate, to 10.50%, employing a larger proxy group.

<u>Risk Premium Models</u>

Dr. Vander Weide was the only witness in this case that conducted an ROE analysis using the Risk Premium Method. The risk premium method is based on the principle that investors expect to earn a return on an equity investment that reflects a "premium" over the interest rate they expect to earn on an investment in bonds. This equity risk premium compensates equity investors for the additional risk they bear in making equity investments versus bond investments. MidAmerican Ex. JHV 1.0 at 27, ll. 596-603.

Dr. Vander Weide's risk premium methods yielded results of 11.20% using the ex ante risk premium method and 10.90% using the ex post risk premium method. MidAmerican Ex. JHV 1.0 at 44; MidAmerican Ex. JHV 2.0 at 16, ll. 327-331. MidAmerican acknowledges that both of these estimates include flotation costs. Without the flotation costs, the ex ante and ex post risk premium methods would produce 11.00% and 10.70% estimates of the cost of equity.

The purpose of a risk premium analysis is to estimate the required return on investment for companies that are comparable in risk to the utility whose cost of equity is being estimated. MidAmerican Ex. JHV 2.0 at 17, ll. 343-356. Staff criticizes Dr. Vander Weide's risk premium analyses because the composition of the proxy group changes over time and because his analysis relies in part on historical risk premium data. Staff Ex. 6.0 at 11, ll. 219-222. MidAmerican argues that these criticisms are misplaced.

MidAmerican counters that, although the composition of the comparable companies in Dr. Vander Weide's risk premium analyses may change over time, at each point time they are the largest possible group of comparable risk utilities with sufficient data to estimate the risk premium cost of equity. Consequently, there is no reason to believe that the changing composition of comparable utilities has a significant impact on the risk premium analyses of MidAmerican's cost of equity.

Additionally, MidAmerican argues it is reasonable for the Commission to review historical information on utility investors' required return on equity because the cost of equity can only be estimated with uncertainty, and the required risk premium on utility equity investments varies inversely with interest rates, i.e., the required equity risk premium is higher when interest rates are lower, as they are at present, than when interest rates are higher. MidAmerican Ex. JHV 2.0 at 18, ll. 361-366. MidAmerican urges the Commission to recognize that the inverse relationship between the required risk premium on utility investments and interest rates can only be determined using historical data. By providing relevant information on the inverse relationship between the required risk premium and interest rates, Dr. Vander Weide's ex ante risk premium approach provides context in estimating MidAmerican's cost of equity that is not included in the DCF and CAPM studies. MidAmerican Ex. JHV 2.0 at 18, ll. 336-370.

Furthermore, MidAmerican argues it is widely recognized that investors' current expectations of the required risk premium are influenced in part by the historical record of the earned risk premium on stock investments of comparable risk. Thus, the ex post risk premium results also provide the Commission useful information for determining MidAmerican's cost of equity in this proceeding. MidAmerican Ex. JHV 2.0 at 18, ll. 371-375. Because past experience may impact future expectations, the ex post risk premium approach is relevant to an assessment of investor expectations, and accordingly is not outdated.

MidAmerican contends it has demonstrated that its recommended return on equity of 10.70% is commensurate with that of comparable risk enterprises; will maintain its financial integrity; and, will allow it to attract capital on reasonable terms. See *Hope* and *Bluefield*. An allowed return on equity for MidAmerican's Illinois electric utility operations of 10.70%, as indicated by the DCF, CAPM, and equity risk premium tests presented in Dr. Vander Weide's testimony, is reasonable and relies on market data investors would consider when applying the DCF, CAPM and equity risk premium tests. The resulting recommendation including MidAmerican's flotation costs will ensure MidAmerican maintains its financial integrity, will be able to attract capital on reasonable terms and will be afforded the opportunity to earn a return commensurate with the returns available to enterprises of comparable risk.

2. Staff's Position

Staff witness Michael McNally estimated MEC's investor-required rate of return on common equity to be 9.56%. Staff Ex. 6.0, Sch. 6.01. Mr. McNally began with Company witness Vander Weide's DCF and CAPM analyses, but corrected the most significant flaws in those analyses to derive his estimate of the cost of common equity for MEC. Mr. McNally applied those models to a sample of twelve companies engaged in electric utility operations ("Comparable Sample"), which is a subset of the Value Line Sample Dr. Vander Weide used in his DCF and CAPM analyses. Staff Ex. 6.0 at 20-21. To construct his sample, Dr. Vander Weide used all the companies deemed by Value Line to be "electric utilities" that: (1) paid dividends during every quarter of the last two years; (2) did not decrease dividends during any quarter of the past two years; (3) have an I/B/E/S long-term growth forecast; (4) have an investment grade bond rating and a Value Line Safety Rank of 1, 2, or 3; and (5) are not the subject of a merger offer that has not been completed. MidAmerican Ex. JHV 1.0 at 25-26. This resulted in his 28-company Value Line Sample. Mr. McNally then applied two additional criteria to improve the sample group's similarity in risk to MEC. First, he eliminated any company that was not classified as "regulated" by EEI. Second, he eliminated any company whose S&P corporate credit rating was not within one notch of MEC's A- rating (i.e., anything other than A, A-, or BBB+). This produced Mr. McNally's 12-company Comparable Sample. Staff Ex. 6.0 at 21.

<u>Proxy Group</u>

According to financial theory, the market-required rate of return on common equity is a function of a company's risk. Thus, Staff argues that to accurately measure MEC's cost of common equity, one must first endeavor to assemble a sample that accurately reflects MEC's risk. Staff states that Dr. Vander Weide failed to demonstrate that the four samples he used as proxies for MEC are of similar risk to MEC. The only criterion that Dr. Vander Weide used to filter his samples for similarity in risk to MEC's electric utility operations is that each of the companies contained in three of the four samples (Value Line Sample, Moody's Sample, and S&P/EEI Utilities Index) is apparently characterized, based on unknown criteria, as a utility. The Value Line and Moody's Samples purportedly go one step farther, limiting those utilities to what they characterize, again based on unknown measures, as electric utilities. Staff Ex. 6.0 at 6-7.

In Staff's opinion, while Dr. Vander Weide failed to demonstrate the similarity in risk of his Value Line and S&P/EEI Utilities Index Samples relative to MEC, leaving their suitability as proxies for MEC in question, there can be no doubt that the Moody's and S&P 500 Samples are unsuitable proxies for MEC. Dr. Vander Weide utilized his Moody's Sample in his ex ante risk premium analysis, which attempts to model the relationship between monthly DCF estimates for the 22 Moody's Sample companies and A-rated utility bonds over 168 months. That should mean 3,696 monthly DCF estimates in total (22 companies x 168 months = 3,696). Unfortunately, an astounding

942 (over 25%) of those DCF estimates are missing from his analysis. Many of those data points are missing because 6 of his 22 Moody's Sample companies no longer exist as independent, market traded companies, some since 2008 or even earlier. In addition, other companies are missing data periodically throughout the measurement period, so DCF estimates could not be derived. Still other DCF estimates are inexplicably left uncalculated, despite having the necessary data, which is both puzzling and troubling. All told, there is not one single month of the 168 months in his data period that has estimates from all 22 companies he included in his analysis. Staff concludes that this is a serious problem because his ex ante risk premium analysis attempts to establish the historical relationship between interest rates and the risk premium for a given sample. However, Staff argues that the continuously changing composition of his sample has blurred that relationship. That is, Dr. Vander Weide failed to isolate the effect of interest rates on the risk premium for any single sample. Instead, the change in the risk premium he measured will be a consequence of changes in two variables (both the interest rate and the composition of the sample), rather than the single variable (i.e., the interest rate) that his analysis assumes. As a result, the relationship he modeled that is the basis of his ex ante risk premium is uninformative, rendering his ex ante risk premium result of no use in the determination of MEC's cost of common equity. Staff Ex. 6.0 at 7-8.

As to the S&P 500 Index, which Dr. Vander Weide used in his ex post risk premium, it represents the market overall with a wide variation of constituent companies, and, in Staff's view, it is clearly not a suitable proxy for a utility such as MEC. Staff Ex. 6.0 at 8. Indeed, the S&P 500 includes companies in every industry from technology to oil to real estate. Furthermore, as a "market" index, it would have an overall beta of approximately one despite Dr. Vander Weide's own observation that electric utilities typically have a beta of significantly less than one. MidAmerican Ex. JHV 1.0 at 41. Thus, the indicated risk level would be significantly higher than that of a typical electric utility. Financial theory suggests that this higher degree of risk would cause the proxy group's cost of common equity to be significantly higher than MEC's cost of common equity. Staff Ex. 6.0 at 8.

<u>Flotation Cost Adjustment</u>

"The Commission has traditionally approved [flotation cost] adjustments only when the utility anticipates it will issue stock in the test year or when it has been demonstrated that costs incurred prior to the test year have not been recovered previously through rates." *Commonwealth Edison Co.,* ICC Order Docket No. 94-0065, 94-95 (January 9, 1995). Moreover, "[the utility] has the burden of proof on this issue." *Id*. Thus, Staff argues that flotation costs are to be allowed only if MEC can verify both that it has incurred the specific amount of flotation costs for which it seeks compensation and that those costs have not been previously recovered through rates. Staff Ex. 6.0 at 3.

Dr. Vander Weide's common stock flotation cost adjustment would compensate MEC for an assumed issuance cost of 5%, which represents a generalized flotation cost estimate based on studies of "issuance expense and market pressure" related to the issuance of new capital. MidAmerican Ex. JHV 1.0 at 25. However, Staff notes that the Commission has repeatedly rejected the use of generalized flotation cost adjustments in previous cases as an inappropriate basis for raising utility rates. *MidAmerican Energy Company*, ICC Order Docket No. 01-0696, 23-24 (September 11, 2002); *Central Illinois Public Service Company and Union Electric Company*, Order Docket Nos. 02-0798/03-0008/03-0009 (Cons.), 83, 89 (October 22, 2003); *Central Illinois Light Company*, Order Docket Nos. 01-0465/01-0530/01-0637 (Cons.), 75, 79 (March 28, 2002). Staff concludes that, since Dr. Vander Weide's flotation cost recommendation is not based upon evidence of issuance expenses that MEC itself has incurred but has not recovered, that recommendation should be rejected. Staff Ex. 6.0 at 4.

DCF Analysis

Staff argues that MidAmerican's DCF estimate incorrectly includes a flotation cost adjustment. Dr. Vander Weide calculated his DCF both with and without that flotation cost adjustment. Therefore, Staff witness Mr. McNally used the results for the Comparable Sample companies without the flotation cost adjustment, with one additional correction. The DCF model requires the input of the value of the expected dividend one year from the date of the analysis ("D1"). However, Staff states that value depends on the expected return on the quarterly dividends expected to be paid throughout the next year. Dr. Vander Weide's calculations of D1, with and without that flotation cost adjustment, are both based on his expected return estimate with a flotation cost adjustment. Since that flotation cost is inappropriate, Mr. McNally adjusted his calculation of D1 to fully remove the effect of Dr. Vander Weide's flotation cost adjustment. Because of that change, the results for five of the sample companies are each 0.01% lower than Dr. Vander Weide calculated. The resulting DCF cost of equity estimate for the Comparable Sample was 9.42%. Staff Ex. 6.0 at 23-24.

Risk Premium Analysis

Staff argues that the two risk premium ("RP") models Dr. Vander Weide used are both critically flawed. First, Dr. Vander Weide's risk premium analyses are plagued by the proxy sample problems. In Staff's view, the change in the composition of his Moody's Sample over the period analyzed is particularly troubling, as it affects the relationship he attempted to model (i.e., it introduces measurement error due to cross-sectional variation in risk). Staff Ex. 6.0 at 11.

Second, Staff states that Dr. Vander Weide's equity premium estimates are calculated from outdated data, which is inappropriate. Use of outdated data wrongly implies that market risk premiums revert to a mean that is observable, despite the fact that security returns approximate a random walk. Therefore, Staff concludes the selection of a measurement period will necessarily be arbitrary, and that arbitrarily selected measurement period will dictate the magnitude of the resulting risk premium, as Dr. Vander Weide acknowledges. MidAmerican Ex. JVH 1.0 at 32.

Third, Staff states that both of his RP models include a flotation cost adjustment that is inappropriate. Fourth, rather than utilizing the current A-rated utility yield of

4.73% as the base yield to which his risk premiums are added, both of his risk premium analyses rely on a dubious 6.64% forecast of A rated utility bond yields. Staff states that this substitution inappropriately inflates his RP results by 1.91%. Staff argues that the use of forecasted interest rates is unnecessary because current interest rates already reflect investors' current expectations for the future. Moreover, as difficult as it is to estimate investors' current required rates of return on common equity, the employment of forecasted interest rates essentially attempts to predict investors' future required rates of return, which compounds the difficulty. In addition, the measurement error for forecasts increases the farther into the future they project. Dr. Vander Weide relied on forecasts of 2017 interest rates, a time horizon over which the economic outlook can change considerably. In fact, Staff points out that just three months after Value Line published the 6.0% forecast of the yield on Aaa rated corporate bonds that Dr. Vander Weide employed, it revised that forecast downward by 50 basis points. Staff Ex. 6.0 at 13.

Fifth, Staff states that Dr. Vander Weide's ex post RP, which is intended to estimate an investor-required return for MEC, is based on the average spread between earned returns and interest rates. However, investor-required returns and earned returns are not the same. That is, by adding the historical average earned return premium to a forecasted interest rate, he created an earned return estimate rather than an investor-required return estimate. Therefore, Staff argues it could only produce the correct investor-required return on common equity by chance. Staff Ex. 6.0 at 13-14.

3. DOD's Position

DoD recommends the Commission award MidAmerican a return on common equity of 9.40%. DoD witness Mr. Gorman applied three versions of the DCF model, and a CAPM using a proxy group of publicly traded companies that have investment risk similar to MidAmerican. DoD/FEA Ex. MPG 1.0 at 2-3. Specifically, Mr. Gorman applied (1) a constant growth DCF using consensus analysts' growth rate projections; (2) a constant growth DCF using sustainable growth rate estimates; (3) a multi-stage growth DCF; and (4) a CAPM.

Mr. Gorman testified that the credit rating agencies consider the electric utility industry to be stable and that investors will continue to provide an abundance of capital to support utilities' large capital programs and at moderate capital costs. According to Mr. Gorman, this supports the belief that electric utility investments are generally regarded as low-risk investments. He stated that demand for low-risk investments will provide funding for electric utilities in general. DoD/FEA Ex. MPG 1.0 at 7.

Proxy Group

Mr. Gorman relied on the same proxy group as MidAmerican, with the exception of one company that he removed from the sample because it was involved in a merger and acquisition activity. *Id.* at 10-11.

DCF Anaysis

Mr. Gorman used the growth rates in his DCF model shown in DoD/FEA Ex. MPG 1.3. He used the average growth rate of 5.36% and a median growth rate of 5.39%. DoD/FEA Ex. 1.0 at 16. The average and median constant growth DCF returns for Mr. Gorman's proxy group were 9.63% and 9.48%, respectively. Mr. Gorman calculated the average and median sustainable growth DCF results of 9.01% and 8.46%, respectively. *Id.* at 19. In Mr. Gorman's multi-stage growth DCF model, Mr. Gorman used the projected five- and ten-year average GDP consensus growth rates of 4.8% and 4.6%. *Id.* at 23. He calculated the average and median multi-stage growth DCF returns on equity of 9.11% and 9.03%. *Id*. at 24. For the three DCF return studies, Mr. Gorman supported a 9.15% return on equity.

Mr. Gorman testified that he relied on a quarterly compounding return in the DCF models because it is the Commission's standard practice; however, he argued that including a quarterly compounding DCF return estimate overstates the utility's cost of capital. *Id*. at 13. This occurs because the return available to investors from reinvesting dividends is not a cost to the utility. *Id*.

Mr. Gorman did not dispute that security analysts' projections are influential with investors. However, Mr. Gorman argued it is not appropriate to ignore as Dr. Vander Weide does, the difference in the time period with the analysts' growth projections are intended to represent (three to five years) and the growth time period needed for the constant growth DCF model (an indefinite long-term period). DoD/FEA Ex. MPG 3.0 at 3. Mr. Gorman stated that analysts' three- to five-year growth rate projections must be reviewed for reasonableness to determine whether or not they are reasonable estimates of long-term sustainable growth as required by the constant growth DCF model. *Id.* According to Mr. Gorman, growth rate cycles may not be constant over time. Therefore, a constant growth DCF analysis may produce an irrational result if a three- to five-year growth rate estimate is used in the DCF study, and the growth rate is either too high or too low to be a reasonable estimate of long-term sustainable growth. *Id.*

Dr. Vander Weide did not agree with Mr. Gorman's use of a sustainable growth DCF study. Mr. Gorman countered that a sustainable growth rate model produces more information that is useful in estimating the current market cost of equity. Therefore, it should not be rejected. *Id*. at 6. Moreover, according to Mr. Gorman, Dr. Vander Weide's concerns regarding the need to project earned return on equity in order to produce a sustainable growth rate estimate are meritless. Mr. Gorman argued that Dr. Vander Weide does not know the information that security analysts use to project their published growth rate estimates. *Id.*

Dr. Vander Weide also objected to Mr. Gorman's use of a multi-stage DCF study by asserting that (1) investors aren't always rational, (2) it is inappropriate to adjust the growth term without also adjusting the stock price, and (3) the DCF model should not require the growth expectations of investors rather than his personal growth rate expectations. *Id*. at 7. Mr. Gorman countered that Dr. Vander Weide failed to show that a DCF analysis for the tech companies, or the real estate market, would have produced reasonable return outlooks that rationally reflect investors' return requirements for investments with highly uncertain cash flows. Mr. Gorman stated that the objective in this case is to establish a rate of return that fairly compensates utility investors, maintains the utility's financial integrity, and accomplishes these at tariff rates that are no higher than necessary. According to Mr. Gorman, these objectives cannot be consistently met if extreme market movements or extreme data are used to estimate a utility's return on equity. *Id*.

CAPM Analysis

Mr. Gorman used Morningstar's market risk premium of 6.7%, a risk-free rate of 4.40%, and a beta of 0.78 in his CAPM analysis, which produced a return of 9.61%, rounded to 9.65%. DoD/FEA Ex. MPG 1.0 at 31.

Dr. Vander Weide argued that Mr. Gorman failed to acknowledge the substantial evidence showing the CAPM tends to underestimate returns for securities with betas less than 1.0. DoD/FEA Ex. MPG 3.0 at 8. Mr. Gorman testified that the use of consensus analysts' growth rate projections provides a broader scope of analysts' recommendations that are considered by investors in making investment decisions. As such, Mr. Gorman stated that a consensus analysts' Treasury bond yield projection is more likely reflective of the consensus investors' expectations compared to a single analyst's projection made by the Value Line Investment Survey. Mr. Gorman argued that his consensus analysts' projection produces a better estimate of the current investor-required rate of return based on current market conditions and interest rate outlooks. *Id.*

Risk Premium Analysis

Mr. Gorman testified that he would normally rely on a risk premium model to support his return on equity recommendations. However, since the Commission consistently rejects this methodology, Mr. Gorman did not use a risk premium model.

4. Commission Analysis & Conclusion

The Commission traditionally relies on the DCF and CAPM models in establishing rate of return on common equity for utilities. The arguments presented in this case do not establish a reason to deviate from this position.

MidAmerican refers to the *Hope* and *Bluefield* decisions stating that the utility should be allowed to earn a return on its investment that is commensurate with returns being earned on other investments of the same risk. In other words, the Company should get a rate of return comparable to companies with similar risk profiles. The question therefore is what constitutes a comparable proxy group. The Commission disagrees with MidAmerican's conclusion that a larger sample group necessarily decreases uncertainty. We agree with Staff's analysis to refine the sample group by eliminating companies that are not regulated and targeting companies that are within one rating difference of MidAmerican's A- rating. The Commission further agrees with

Staff's analysis that accuracy is not a function of the size of the sample, but rather the composition of the sample in how close the sample reflects the risk of the target company.

MidAmerican argues that equity risk is different from bond risk and that bond ratings are a poor indicator of the risk of investing in a company's equity. While we agree that equity risk is different than bond risk, the Commission disagrees with the Company's assessment that bond ratings are not a viable tool used in an individual's determination to invest equity into a company. If bond ratings were a poor indicator of a company's financial health, then Staff's calculations would not have resulted in any difference between samples of different rating profiles. See Staff Ex. 15.0C at 7.

The Commission agrees with Staff's analysis that the less likely a company is to meet its financial obligations (lower credit rating), the less likely that company is to maintain residual value for its equity investors (higher equity risk), which would cause equity investors to require higher returns to compensate for the higher risk. As Staff correctly states, corporate credit ratings do reflect the general financial strength of a company.

MidAmerican also proposes a flotation cost adjustment of 5% (23 basis points). As Staff notes, the Commission traditionally approves flotation cost adjustments only upon a showing that the utility anticipates issuing stock in the test year or if the utility demonstrates that costs incurred prior to the test year were not previously recovered through rates. Rather than providing such evidence to justify a flotation cost adjustment, MidAmerican proposes a general flotation cost adjustment of 5% similar to what the Commission has considered and rejected in the past.

MidAmerican further proposes using two Risk Premium models in the ROE analysis. The Commission does not rely on the Risk Premium analysis and MidAmerican did not provide sufficient evidence for the Commission to include the results from the Risk Premium models in the determination of MidAmerican's return on equity. Moreover, the Commission agrees with Staff's analysis that the models contain critical flaws including sample problems such as changes in composition of the Moody's Sample over the period analyzed, and that the equity premium estimates are calculated using outdated data. Further, the Risk Premium models also contain the flotation cost adjustment, which the Commission has rejected.

Based on the evidentiary record and our forgoing analysis, the Commission finds that Staff's cost of equity analysis provides the best analysis for determining the rate of return in this proceeding. The Commission notes that DoD used a similar sample group as the Company, and therefore its DCF and CAPM models are also rejected. Staff's 9.56% cost of common equity is reasonable and is hereby adopted.

E. Weighted Average Cost of Capital

Based upon our previous findings regarding capital structure and costs of various capital components, the Commission concludes that MidAmerican should be authorized a 7.14% rate of return on rate base. Consistent with this conclusion, the following table shows how the rate of return on rate base to be used for ratemaking purposes is calculated:

Source of Capital	Amount	Proportion (%)	Cost (%)	Weighted Cost (%)
Long-term Debt	$ 3,525,119,953	48.27	4.53	2.19
Common Stock	$ 3,777,734,285	51.73	9.56	4.95
Total	$ 7,302,854,238	100.00		7.14

VII. RIDERS

A. Transmission Cost Recovery Rider

MidAmerican proposed Rider TS, which is a mechanism for recovering MidAmerican's transmission-related costs from those retail customers that receive power and energy from MidAmerican rather than from alternative retail electric suppliers ("ARES"). MidAmerican Ex. DAS 1.0. The objective of Rider TS is to replicate, for those customers taking bundled service from MidAmerican, the transmission charges the Midcontinent Independent System Operator, Inc. ("MISO") would apply to an ARES serving load in the MidAmerican service area.

Rider TS segregates all transmission costs incurred by MidAmerican into a single charge. *Id*. at 4, ll. 56-57. There are two categories of transmission costs included in the Rider: (1) charges for MidAmerican's Illinois retail load use of the transmission system, including MISO ancillary services charges associated with serving load in a local balancing area, and (2) an allocation of several transmission charges imposed by MISO. Given the current FERC-approved MISO rate schedules, the costs that would be recovered through Rider TS in this second category include: (A) imputed charges under MISO Tariff Schedules 1 and 9, and (B) an allocation of actual charges assessed under Schedules 10, 10-FERC, 26 and 26-A, using the "Non-Specific Plant / Traditional Average and Excess Allocator." In designing Rider TS, MidAmerican followed the general approaches used by Ameren Illinois. Because MidAmerican is a multi-jurisdictional utility, Rider TS allocates a portion of the total charges paid to the Illinois jurisdiction. MidAmerican also proposes an annual reconciliation of Rider TS charges similar to Ameren.

Staff does not object to MidAmerican's implementation of Rider TS as long as MidAmerican excludes all transmission-related costs from its ICC-jurisdictional revenue requirements, as long as FERC only approves reasonable transmission service revenue requirements, as long as the Rider is used to recover only the imputed and actual costs described in Mr. Stevens' testimony, and as long as it is reasonable to use the "Non-Specific Plant / Traditional Average and Excess Allocator" to allocate to Illinois a portion of MidAmerican's incursion of MISO transmission charges, then the Rider will not systematically over-recover the actual transmission costs that are incurred to serve Illinois load. Staff Ex. 9.0 at 4-5, ll. 62-103.

MidAmerican proposed specific tariff language to implement the cost recovery of MidAmerican's jurisdictional transmission revenues as costs through Rider TS. MidAmerican Ex. DLK 1.0 at 21, ll. 444-448. Staff, however, recommended that Rider TS be revised to include further explanation of the terms, reconciliation proceedings, and adjustments ordered by the Commission among other clarifications. Staff Ex. 1.0 at 7-8, ll. 142-172.

In response to Staff's concerns, MidAmerican changed Rider TS to address Staff's concerns. Rider TS was revised as follows: consistent use of "Rider TS" in the terminology; more clearly describing the requirements for an annual reconciliation proceeding; adding a provision for Commission ordered adjustment through a new factor "O"; specifying three tests to be performed in the internal audit; clarifying time periods listed in Rider TS; and clarifying that factor "C" established for midyear adjustments would be in effect through the following March 31. MidAmerican Ex. DLK 2.0 at 3-4, ll. 56-73. Staff indicated the changes in the revised Rider TS addressed the concerns and that the Commission should adopt Rider TS as revised, if the Commission approves MidAmerican's request to implement Rider TS. Staff Ex 10.0 at 6-7, ll. 121-127.

As outlined above, the implementation of Rider TS is uncontested and produces just and reasonable transmission rates. Accordingly, the Commission finds the revised Rider TS is reasonable.

B. Uncontested Riders Eliminated

MidAmerican proposed to eliminate several riders in its new tariff. No party objected to the elimination of these riders. The following discussion outlines the riders MidAmerican proposes to eliminate and the reasons for their elimination. MidAmerican Ex. DLK 1.0 at 15-20, ll. 306-408. The Commission finds that it is reasonable for the Company to eliminate the following riders:

1. Rider No. 3 – Commercial Electric Space Heating

MidAmerican proposed to eliminate Rider No. 3 – Commercial Electric Space Heating since MidAmerican does not provide a separate space heating rate for residential or industrial customers. Further, the existing tariff requires the customer to install wiring to accommodate separate measurement of the electricity used for space heating during the winter months. Consumption measured by such meters for the Company's June, July, August, and September billing periods is included along with other uses at the applicable rate. MidAmerican Ex. DLK 1.0 at 16-17, ll. 332-340.

2. Rider No. 4 – Interruptible Service

MidAmerican proposed to eliminate Rider No. 4 – Interruptible Service. The current tariff is available only to customers taking service under this Rider No. 4 on May

31, 2008, and no new customers have been allowed to take service under the rider since that date. This rider is very similar to the current Rider 14: Curtailment Services, which is proposed to be replaced by a minimally-revised Rider CS: Curtailment Service. It is reasonable to eliminate this rider since there is no need for two similar riders. MidAmerican Ex. DLK 1.0 at 17, ll. 341-348.

3. Rider No. 5 – Limited Term Contract Service

MidAmerican proposed to eliminate Rider No. 5 – Limited Term Contract Service. The purpose of this rider is to retain, attract, and expand electricity sales in a manner which allows economic operation by the customer and provides a contribution to the Company's fixed costs. A provision of the rider is that all contracts for service under this rider shall terminate no later than May 15 of the year in which the Company must commit to construct intermediate or base load capacity to serve ultimate consumers and full requirements wholesale service. While MidAmerican has not constructed base load capacity to serve Illinois customers, MidAmerican has built base load capacity in Iowa. MidAmerican Ex. DLK 1.0 at 17, ll. 349-360.

4. Rider No. 11 – Economic Development

MidAmerican proposed to eliminate Rider No. 11 – Economic Development because this rider has expired. The rider specified that no individual customer term shall be longer than 60 months and no billing adjustments shall extend beyond the December 1999 billing period. MidAmerican Ex. DLK 1.0 at 18, ll. 361-366.

5. Rider No. 13 – Municipal Compensation Adjustment

Rider No. 13 Municipal Compensation Adjustment allows MidAmerican to recover franchises or other government fees or charges from customers within the governmental unit. MidAmerican proposed to eliminate Rider No. 13 because MidAmerican is not currently required to pay any franchise or other government fees or charges and has not used Rider No. 13 since 1995. MidAmerican Ex. DLK 1.0 at 18, ll. 367-374.

6. Rider No. 15 – Optional Commercial Time of Day Service

MidAmerican proposed to eliminate Rider No. 15 – Optional Commercial Time of Day Service since MidAmerican is proposing separate Time-of-Use rates rather than layering a rider on top of commercial rates. MidAmerican Ex. DLK 1.0 at 18, ll. 375-379.

7. Rider No. 17 – Non-Residential Real Time Pricing

MidAmerican proposed to eliminate Rider No. 17 – Non-Residential Real Time Pricing as MidAmerican is exempt from the legislative requirement to offer this rate. Further, this is an optional rate and no customers have selected this rate in over ten years. MidAmerican Ex. DLK 1.0 at 18-19, ll. 380-385.

C. Uncontested Changes to Existing Riders

1. Energy Efficiency Cost Recovery Factor

MidAmerican proposed to delete Factor E from the calculation and from the definition of embedded costs. MidAmerican Ex. DLK 1.0 at 19-20, ll. 398-435. No parties objected to this deletion of the factor. Accordingly, the revision is reasonable and is adopted by the Commission.

2. Fuel Adjustment Clause

Through this rate filing, MidAmerican will continue to implement FAC. As a result, MidAmerican proposes to roll all fuel costs out of base rates and set Factor BFC, base fuel costs, to zero. This change will have no impact on the total, but will provide greater transparency as to total fuel costs paid by the customer. MidAmerican Ex. DLK 1.0 at 21, ll. 436-441.

VIII. COST ALLOCATION AND RATE DESIGN

MidAmerican presents a cost of service study ("COSS") that is used in determining rates. First, MidAmerican allocates its revenue requirement to each functional category. Second, MidAmerican allocates each functional category to the customer classes. MidAmerican Ex. CBR 1.0 at 4-5. The functional categories are generation, transmission, substations, three-phase wires, single-phase wires, transformers, services, meters, customer accounts and lighting. *Id.* at 5. MidAmerican assigns most of the revenue requirement accounts directly to a single function. *Id.* For accounts that are not directly assigned to a single function, MidAmerican allocates them based on the net plant or payroll dollars associated with each function. *Id.* at 6.

A. Contested Issue – The Hourly Costing Model

MidAmerican's Position

MidAmerican's cost of service study used the Hourly Costing Model ("HCM") to allocate generation costs, used a 12 Coincident Peak ("12 CP") allocator for transmission costs, a non-coincident peak ("NCP") allocator for substation costs and a split system distribution wires allocator. Weighted costs for transformers, services, meters and customer accounts are included in the calculation of class customer charges. Lighting costs are directly allocated to the lighting classes. See generally, MidAmerican Ex. CBR 1.0 at 3-16, ll. 39-351.

MidAmerican presented evidence supporting the use of the HCM for allocation of generation costs in its cost of service study. The HCM is a method for pricing generation service to retail customers. The HCM prices generation service on a non-discriminatory basis based on customer load shapes and usage patterns, and the cost of acquiring and producing generation at different times of the day and different times of the year. MidAmerican Ex. CBR 1.0 at 8, ll. 138-142.

The goal of the HCM methodology is to assign a price for generation to each hour of the year. *Id*., ll. 144-145. The generation revenue requirement assigned to each customer class under this methodology results from applying each class' hourly load profile to the hourly price profile generated by the HCM, loads multiplied by prices. MidAmerican Ex. CBR 1.0 at 8, ll. 145-148. The ratio of total generation cost resulting from this cross-multiplication of loads and prices for a single class to the total generation cost for all classes is then used to allocate MidAmerican's generation-related revenue requirements to that customer class. *Id*., ll. 148-152.

MidAmerican explained the HCM calculates a generation price for each hour of the year by assigning a cost to each MWh in the retail system load curve. *Id*., ll. 155-156. For any given hour, the HCM methodology calculates the average of the costs for all MWh in that hour to determine the average generation price for that hour. *Id*., ll. 156-158. Each MWh in the retail system load curve is assigned a cost that contains two components; an energy component and a capacity component. *Id*., ll. 161-163.

MidAmerican contends the HCM is a reasonable cost of service method for pricing generation because of the following reasons:

- The HCM methodology rewards customer groups whose load characteristics, load patterns, and time of use characteristics result in lower costs to serve.
- The HCM methodology also rewards customer groups with higher load factors. Customer groups with high load factors are allocated a lower generation cost (on a per unit basis) than customer groups with lower load factors.
- The HCM methodology results in pricing for generation services that is non-discriminatory.
- The HCM model is both a de facto cost allocation model and a pricing model. Unlike traditional cost allocation methodologies, results from the HCM model can be used directly in the ratemaking process. The HCM model is more precise than other models that use broad assumptions to estimate cost characteristics that are subject to variability over the course of a day.
- Results from the HCM model are more stable from year to year than traditional generation cost methodologies because the HCM model considers energy consumption patterns all through the year, as opposed to traditional methods that rely on a single hour's demand reading that can change significantly from test year to test year. Rather than have rates be heavily influenced by a single hour in the year, rates reflect cost causation over all hours of the year.

See MidAmerican Ex. CBR 1.0 at 11-13, ll. 227-254.

In its initial filing, MidAmerican based the energy component of each MWh on the MISO Locational Marginal Price ("MISO LMP") for the MidAmerican retail load zone node associated with the hour of the year the MWh is produced. *Id*., ll. 164-167.

In its direct testimony, Staff proposed to modify the HCM such that the energy component of the HCM reflects retail fuel costs only, as opposed to reflecting the actual value of the hourly MISO LMPs, with all non-fuel generation costs allocated to and contained within the capacity component of the HCM. MidAmerican Ex. CBR 2.0 at 3, ll. 35-39.

MidAmerican agreed with Staff's modification and agreed that the proposed change better segregates retail fuel costs from non-fuel costs in the HCM. This change allocates more costs to lower load factor customers and removes any concerns over the potential double-counting of capacity cost in the energy component of the HCM. MidAmerican Ex. CBR 2.0 at 3-4, ll. 41-46.

MidAmerican states that both DoD and Deere complain the HCM is untested and fail to recognize that high load factor customers are less costly to serve. MidAmerican argues the DoD's concerns regarding the use of MISO LMP data are misplaced and were addressed by modifying the HCM as recommended by Staff.

According to MidAmerican, Deere's complains that the HCM does not recognize that higher load factor customers are less costly to serve. MidAmerican counters it provided evidence that shows a comparison of class average generation costs on a $/MWh basis to class load factors from the modified HCM. MidAmerican Ex. CBR 2.0 at 5, ll. 70-75; MidAmerican Ex. CBR 2.1, Sch. A. MidAmerican Ex. CBR 2.1 shows that with the exception of the lighting class, there is a very clear and distinct relationship between average generation cost and load factor. MidAmerican Ex. CBR 2.0 at 5, ll. 73-81. The correlation between class average generation cost and class load factor is -97%, which is nearly perfect. Consequently, with the exception of the lighting class, MidAmerican argues customer classes with higher load factors enjoy better generation costs on a per unit basis than classes with lower load factors under the HCM. *Id*., ll. 79-81.

MidAmerican further argues Deere's contention that the HCM does not recognize the lower cost to serve high load factor customers is incorrect and the Commission should not give any weight to this concern.

Both Deere and DoD complain that the HCM over-allocates capacity cost to higher load factor classes. MidAmerican counters that neither Deere nor DoD have offered any objective evidence as the basis for this contention. Moreover, MidAmerican argues that neither DoD nor Deere have presented the Commission with any alternatives for the HCM to be compared against. MidAmerican further contests that MidAmerican Ex. CBR 2.1, Sch. A demonstrates that higher load factor customer classes enjoy a better per unit generation price under the HCM than lower load factor classes, excluding lighting customers.

Deere and DOD further contend the HCM produces inefficient price signals which will cause customers to use energy in an inefficient manner, discourage demand management, and artificially establish a need for new capacity prematurely. Deere Direct at 10, ll. 5 through 11, l. 2; DoD/FEA Ex. MPG 1.0 at 50, ll. 1030-1041.

MidAmerican argues, however, that the price signals under the Modified HCM are clear, unmistakable, and accurate. Customer classes that use high amounts of energy during times of high system load (residential customers, for example) pay the price for that energy and pay relatively high average generation prices under the HCM. Customer classes that use little or no energy during times of high system load (lighting, for example) or that use a large amount of energy during off-peak periods as compared to on-peak periods (industrial classes, for example) enjoy favorable pricing under the HCM. MidAmerican Ex. CBR 2.0 at 7, ll. 125-129.

Moreover, MidAmerican argues the Iowa Utilities Board also recognized that the HCM sends price signals that accurately reflect the competitive electric market. *In Re: MidAmerican Energy Company*, IUB Docket No. RPU-2013-0004, Order Approving Settlement, with Modifications, and Requiring Additional Information at 79 (March 17, 2014) and Order on Rehearing (July 10, 2014). While MidAmerican recognized IUB's decision is not binding on the Commission, MidAmerican notes the IUB's recent decision is nonetheless instructive.

Deere also argues that the HCM is divorced from cost causation for the capacity component of MidAmerican's owned and long term capacity rights and MidAmerican does not procure capacity hourly. Deere Reply Brief at 5. Deere also complains that MidAmerican's legal generation capacity obligation is to satisfy requirements of Module E of the MISO tariff; therefore, its generation capacity component of cost of service should be much more strongly correlated to one summer peak and not 8,760 demand values. Kaman Rebuttal at 5 lines 10-13. Deere complains error is the fundamental mechanism by which higher load factor customers are harmed by the HCM. Deere Reply Brief at 6.

MidAmerican countered that while capacity is not "acquired" on an hourly basis, some amount of capacity is needed to serve load in every hour of the year. By using MISO LMPs and weighted capacity costs for all hours in the year, more accurate market-based information is reflected in the HCM allocator, which in turn reflects more accurate costs to serve customers for every hour. Staff Ex. 7.0 at 11, ll. 235-239.

Deere further complains MidAmerican has not provided a more traditional alternative in the record, such as the Average and Excess method. MidAmerican argues that, under Commission rules, MidAmerican is not required to provide multiple cost of service studies so Deere can pick and choose which allocates cost in a manner that benefits Deere's load shape the most. MidAmerican has not shown inefficiency or bad faith in this case. MidAmerican is obligated to present a cost of service study that allocates the costs equitably among all customer classes. It is then up to Deere to establish either that the HCM is unreasonable or that some other methodology is preferable. For the reasons Staff and MidAmerican outlined in testimony and in briefs, MidAmerican argues that Deere has simply failed to establish that the HCM unreasonably allocates generation costs.

Staff's Position

Staff argues the Commission should approve the Company's HCM, with Staff's modification, to assign generation costs to customer classes. See Staff Ex. 7.0 at 8, 11-12; Staff Ex. 16.0 at 1-2. In Staff's opinion, the HCM, with Staff's modification, reflects the hourly cost to serve customers based on the Company's participation in the MISO market. Staff Ex. 7.0 at 11-12. It is from the MISO market that the Company obtains the energy and capacity to serve its customers. MidAmerican Ex. CBR 1.0 at 10. The generation costs assigned to customer classes using the HCM consist of both energy costs and generation plant costs. Staff Ex. 7.0 at 7. HCM is designed to assign generation costs to customer classes based on customer load shapes and usage patterns during different hours of the year. MidAmerican Ex. CBR 1.0 at 10. Both Deere and DoD/FEA oppose the HCM arguing that it does not reflect cost causation. See, generally, DoD/FEA Ex. 1.0, 3.0; Deere Kaman Direct and Rebuttal testimony. However, Staff points out that neither Deere nor DoD/FEA offer an alternative COSS analysis. *Id*.; see also MidAmerican Ex. CBR 3.0 at 6.

Staff states that the HCM the Company initially proposed: (1) over-allocated generation costs to high load factor customers and under-allocated costs to low load factor customers; and (2) potentially lead to double counting of capacity costs. Staff Ex. 7.0 at 8. Staff's modification is to assign costs between the energy and capacity components such that only retail fuel costs are allocated to the energy component and all non-fuel generation costs are allocated to the capacity component. *Id*. The Company accepted Staff's proposed revision to the HCM methodology in rebuttal testimony, and agreed that Staff's modification better segregates retail fuel costs from non-fuel costs in the HCM. MidAmerican Ex. CBR 2.0.

Staff maintains that Deere's argument against the HCM is flawed because Deere incorrectly assumes that, because MISO Module E requires the Company to own or acquire an amount of capacity equal to its annual peak load plus a reserve margin, this generation capacity is for only times when demand is at its highest. As Staff explained in rebuttal testimony, however, generation capacity is needed to meet demand at all hours including off-peak hours. Staff Ex. 16.0 at 6. Staff states that otherwise there would be no need for generation plants to operate at all during off-peak hours. *Id*. Accordingly, under the HCM, hours with high demands have greater costs assigned, and hours with lower demands have fewer costs assigned. *Id*. This occurs because the capacity component of the HCM is computed by weighting the load level by the number of hours that retail load is at that level. *Id*. Therefore, in Staff's opinion, the capacity component of the HCM assigns the correct generation capacity costs to all hours, including off peak hours.

Staff rejects Deere's argument the results of the HCM do not appropriately reflect the cost causation ratemaking principle. Staff argues that Deere incorrectly believes the HCM over allocates generation costs to high load factor customers. According to Staff, Deere assumes an alternative method, such as the Average and Excess method, would result in a lower amount of costs assigned to high load factor customers, and because it achieves this result, appropriately assigns costs to cost causers. Staff points out that no party advocated for using the average and excess method in this proceeding. Staff argues that Deere ignores the fact that by assigning costs based on an hourly basis, the HCM appropriately assigns costs to cost causers.

Deere's Position

In allocating generation costs, in particular capacity costs, to every hour of the year, Deere argues that the HCM overstates the responsibility of high-load factor customers for generation system costs and over allocates generation costs to customers. DoD/FEA Ex. MPG 1.0 at 10-11. Therefore, Deere argues, the HCM is flawed because it does not adequately reflect cost causation in its allocation of generation capacity costs.

Deere further argues that this is an untested methodology that does not appear to be in use in other jurisdictions. Tr. at 20-21. Additionally, Deere points out that providing an alternative for allocating capacity costs, such as the average and excess methodology, would not be difficult and is a "fairly simple calculation." Tr. at 22.

According to Deere, Staff's modification to the HCM does not correct for the generation capacity to appropriately reflect cost causation in terms of the amount of capacity MidAmerican requires. Kaman Direct at 6-7; DoD/FEA Ex. MPG 3.0 at 10-11.

DoD's Position

DoD provided the testimony of Michael P. Gorman. Mr. Gorman testified that the HCM "departs from reality in the use of marginal energy and marginal demand cost components that differ radically from the actual demand and energy costs on the MidAmerican system that are used to determine revenue requirements." DoD/FEA Ex. MPG 1.0 at 49. According to Mr. Gorman, the HCM significantly over-allocates generation cost to high load factor customers, and under-allocates costs to low load factor customers. *Id*. Mr. Gorman testified that the lower emphasis of generation demand costs will signal customers that peak loads are not important, which will require new capacity to be added. *Id.* Mr. Gorman further argued that, because prices are not based on cost causation and actual cost of service, customers cannot get efficient prices signals to make informed consumption decisions. *Id*. at 50.

Mr. Gorman testified that Staff's adjustment provides slightly more accurate results. DoD/FEA Ex. MPG 3.0 at 11. Nevertheless, Mr. Gorman argued that the HCM method remains fundamentally flawed.

In the absence of a different COSS using a method other than HCM, Mr. Gorman recommended an adjustment to the large load customer classes. Specifically, Mr. Gorman recommended that the increase to Rate LGS be no more than 74% of the overall system average increase, and that the increase to Rate VLGS be no more than 78.7% of the overall system average increase. DoD/FEA Ex. MPG 1.0 at 50-51.

Commission Analysis & Conclusion

The Commission finds that MidAmerican provided sufficient justification for using the HCM as modified by Staff. Staff's modification to the HCM, as accepted by MidAmerican, better segregates retail fuel costs from non-fuel costs. Record evidence supports a finding that the HCM will accurately assign generation costs to customer classes.

Deere's and DoD's arguments that the HCM will over allocate costs to high load factor customers is not persuasive, and neither party provided evidence supporting a more reasonable alternative method. In the absence of another COSS, Mr. Gorman recommends an adjustment to the large load classes. However, Mr. Gorman provides no evidence supporting his recommended adjustment. Accordingly, the Commission will not adopt Mr. Gorman's adjustment to Rate LGS and Rate VLGS.

B. Uncontested Issues

1. Rate Design

Staff and MidAmerican agree that MidAmerican's cost of service study appropriately functionalizes and allocates costs to customer classes. Staff recommends that MidAmerican's basic service charges reflect the cost of service. Staff Ex. 7.0 at 14, ll. 309-306. MidAmerican accepts Staff's recommendation to set the basic service charge at cost of service, resulting in a residential basic service charge of $7.75. MidAmerican Ex. CBR 2.0 at 9, ll. 157-170. The Commission finds the $7.75 residential basic service charge reasonable.

Single-Phase and Three-Phase Split System Methodology

MidAmerican originally proposed to include a split distribution allocation for single and three phase distribution. MidAmerican Ex. CBR 1.0 at 14, ll. 283-308. Staff, however, proposed an alternative allocation employing a single non-coincident peak ("NCP") demand allocator for all distribution wire costs. Staff Ex. 7.0, ll. 59-61. Staff based its recommendation on recent Commission decisions and Staff's familiarity with MidAmerican's Illinois distribution system.

MidAmerican agreed with Staff's recommended NCP allocator for distribution wire, with the exception that the Very Large General Service ("VLGS") class not be allocated distribution wires. MidAmerican Ex. CBR 2.0 at 8, ll. 142-151. MidAmerican testified that all four customers in the VLGS class take service directly from a distribution substation and are responsible for very little distribution wires costs on MidAmerican's system, if any at all. Therefore, it is not reasonable to allocate distribution wires cost to these customers. MidAmerican Ex. CBR 2.0 at 8, ll. 144-151.

Based on the foregoing, the Commission finds the NCP allocator is reasonable and approves the NCP allocator for distribution wires to all customer classes except the VLGS customers.

Transmission Cost Allocation

The Company's use of the 12 CP methodology to allocate transmission costs is not contested. The 12 CP allocator is reflective of MidAmerican's transmission costs, as MidAmerican is assessed for transmission costs monthly by MISO on a load ratio share basis. MidAmerican Ex. CBR 1.0 at 13-14, ll. 259-282. Accordingly, the Commission finds the 12 CP allocator for transmission is reasonable and hereby approved.

Supply Procurement

MidAmerican provided testimony regarding its generation supply and the challenges of harmonizing the different regulatory and legislative frameworks between states. MidAmerican Ex. NGC 1.0 at 10, ll. 188-198. MidAmerican noted that its current allocation methodology may not be viable much longer given the possible retirement of generation currently allocated to Illinois to meet customer demand. *Id*. at ll. 199-220. To address this issue, MidAmerican requested to establish a non-fuel cost per MW in this proceeding that could potentially be used to make future pricing adjustments in specific situations, but the Commission would at a later time determine whether such pricing adjustments should be made. See generally, MidAmerican Ex. NGC 1.0 at 10-15, ll. 188-304, and MidAmerican Ex. NGC 2.0 at 4, ll. 55-65. This cost would be determined by dividing the non-fuel generation costs approved for use in MidAmerican's functional cost-of-service study used to set rates in this proceeding by the 539.8 MW assigned to Illinois in the test year. The resulting cost would be $117,412 per MW based on MidAmerican's filed values. MidAmerican Ex. NGC 1.0 at 13, ll. 269-270.

Staff indicated it did not object to this approach in this proceeding as long as it is clear the Commission is not making a determination in this case about the nature of any generation cost allocation and pricing mechanism that may be considered in some future proceeding. Staff Ex. 9.06 at 6, ll. 111-122. As noted above, MidAmerican agreed that its intent was not to limit the Commission's determination.

Accordingly, the Commission approves the calculation of MidAmerican's cost of generation as presented in MidAmerican Ex. 1.1 Schedule A using final generation rate base, operating costs and return as determined in this proceeding. The Commission notes its determination of the generation cost calculation in this case does not limit the Commission's determination in any future cases regarding generation cost allocation.

2. Weather Normalization

MidAmerican proposed a weather normalization pro forma adjustment designed to determine a level of retail sales and revenues under existing rates that could be reasonably expected given normal weather conditions, thus eliminating the effect on test year retail sales and revenues of having unusually mild or extreme weather during the test year. MidAmerican estimated that about 32% of electricity sold to residential customers and about 12% of electricity sold to commercial customers is used for cooling and heating and is therefore weather dependent. MidAmerican Ex. CBR 1.0 at

19, ll. 393-395. As a result, the level of annual revenue that is collected from volumetric charges associated with this electricity usage is dependent on how hot or mild the summer season is, and how cold or mild the winter season is. Hot summers and cold winters will result in MidAmerican collecting a higher level of revenue than it normally otherwise would, and mild summers and winters will result in MidAmerican collecting a lower level of revenue. *Id*., ll. 395-401.

Accordingly, MidAmerican proposed weather normalization pro forma adjustments for the Residential, Small General Service – Energy, and Small General Service – Demand customer classes. MidAmerican Ex. CBR 1.0 at 19, ll. 391-425. The weather normalization pro forma adjustment reduces total test year revenue by $891,839.

No party takes issue with how MidAmerican's weather normalization pro forma was determined. The Commission finds MidAmerican's weather normalization is consistent with Commission rules and finds it is reasonable to adopt MidAmerican's recommend weather normalization pro forma adjustment.

3. Unbundled Bill

MidAmerican proposed to unbundle its bill to set out various elements of the bill separately in the following categories:

- Basic Service Charge
- Meter Service Charge
- Supply Charge
- FAC
- Delivery Charge
- Transmission Service Charge
- Taxes and other surcharges.

MidAmerican Ex. DLK 1.0 at 23-24, ll. 491-517.

This issue is not contested. The Commission finds this format reasonable and approves the proposed bill format.

IX. TARIFF REVISIONS

A. Uncontested Miscellaneous Tariff Issues

1. Tariff Reorganization

MidAmerican's proposed electric tariffs contain a complete revision of the four existing Illinois electric tariffs. MidAmerican proposes to combine all four tariffs for these services into a single tariff and to cancel Schedule of Rates for Electric Service in Illinois, Ill. C. C. No. 1; Schedule of Rates for Electric Delivery Service in Illinois, Ill. C. C. No. 6; Schedule of Rates for Supplier Electric Delivery Service in Illinois, Ill. C. C. No.

7; and Schedule of Rates for Supplier Metering Service in Illinois, Ill. C. C. No. 8 and replace them with a new single MidAmerican Energy Company Rates for Electric Service in Illinois, Ill. C. C. No. 10. The proposed electric tariff consolidates the terms and conditions, rules and regulations, and rate schedules for all services and provides a single table of contents. This reorganization will make it easier for customers, suppliers, employees and regulators to use MidAmerican's tariff. The organization of the electric tariff will now be consistent with MidAmerican's gas tariff previously approved by the Commission in Docket No. 09-0312. MidAmerican Ex. DLK 1.0 at 3-15, ll. 38-305.

MidAmerican proposed to eliminate two rates. Elimination of Rate 9 was proposed for administrative efficiency. A relatively small number of customers qualify for the rate each year, but resources are required to review each residential account each year. Additionally, it can be confusing for customers to be switched back and forth from Rate 9 to Rate 10 from year to year. MidAmerican Ex. DLK 1.0 at 16, ll. 321-323. MidAmerican also proposed to eliminate Rate 45 – Municipal General Light and Power as separate load information is not available for Rate 45 accounts; they are included with the commercial load sample. Municipal accounts will be moved to the appropriate commercial or industrial rate. MidAmerican Ex. DLK 1.0 at 16, ll. 328-331. No party opposed the elimination of these two rates.

The Commission finds the tariff reorganization and rate elimination reasonable and approves the changes.

2. Reconnection Fee

MidAmerican proposes to update charges for reconnection following a disconnection of service. Tariff No. 1 currently includes a charge of $25 for reconnection at the meter after disconnection for non-payment. This charge has been in place since 1995. MidAmerican proposes to adopt a time and materials charge for reconnection of service. Consistent with Commission rules, one reconnection charge per year will be waived. MidAmerican Ex. DLK 1.0 at 8, ll. 142-147.

This issue is not contested. The Commission finds the reconnection fee reasonable.

3. Refunds for Billing Adjustments

Staff recommended that MidAmerican's proposed refund language be revised to allow a period of two years for refunds for all customers to be consistent with the Act. Staff Ex. 7.0 at 24-25, ll. 525-544. MidAmerican agreed with Staff's recommendation and noted the original language was an inadvertent error. MidAmerican Ex. DLK 2.0 at 3, ll. 38-44.

The Commission finds the tariff language, as modified by Staff to be consistent with the Act and therefore reasonable.

4. Changes to Definitions

Staff recommended that any definitions that are currently contained in MidAmerican's Rate Schedules, Clauses, and Riders not be removed as proposed. Staff Ex. 7.0 at 3, ll. 62-63 and at 24, ll. 516-524. MidAmerican agreed to retain the definitions in those sections of the electric tariff. MidAmerican Ex. DLK 2.0 at 3, ll. 46-54.

The Commission finds the retention of the definition section of the tariffs to be reasonable.

B. Uncontested Non-Substantive Tariff Changes

MidAmerican proposed the following non-substantive tariff changes to electric tariff Ill. C. C. No. 10. Following the filing of this rate case, several typographical and grammatical errors were discovered. MidAmerican Ex. DLK 2.0 at 10-11, ll. 195-206. MidAmerican revised Tariff Sheet No. 469 to reflect the requirement for the Rider EECR charge to be a separate line item as required by the final order in Docket Nos. 13-0423 and 13-0424.

Additionally, Sheet Nos. 364 and 365, which show the residential bill form, were updated to reflect the separate line item for Rider EECR. See MidAmerican Ex. DLK 2.1, Sch. F and C. MidAmerican Ex. DLK 2.0 at 10, ll. 195-206.

The Commission finds these tariff changes and updates reasonable.

X. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having reviewed the entire record herein and being fully advised in the premises, is of the opinion and finds that:

(1) MidAmerican Energy Company is an Iowa corporation engaged in the generation, transmission, distribution and sale of electricity to the public in Illinois and as such is a public utility within the meaning of the Public Utilities Act;

(2) the Commission has jurisdiction over the parties and over the subject matter herein;

(3) the findings and conclusions stated in the prefatory portion of this Order are supported by the evidence of record and are hereby adopted as findings of fact; Appendix A attached hereto provides supporting calculations for various portions of this Order;

(4) the test year for the determination of the rates herein found to be just and reasonable is the historical test year ending December 31,

2012, with pro forma adjustments; such test year is appropriate for purposes of this proceeding;

(5) for purposes of this proceeding, MidAmerican's net original cost of electric rate base is $334,116,000.

(6) MidAmerican should be allowed an opportunity to earn a just and reasonable rate of return on its net original cost electric rate base of 7.14%; this rate of return incorporates a rate of return on common equity of 9.56%;

(7) MidAmerican's rates which are presently in effect for electric service are insufficient to generate the operating income necessary to permit MidAmerican the opportunity to earn a fair and reasonable return on net original cost rate base; these rates should be permanently canceled and annulled;

(8) the rates proposed by MidAmerican for its electric operations will produce a rate of return in excess of a return that is fair and reasonable; MidAmerican's proposed electric rates should be permanently canceled and annulled;

(9) MidAmerican should be authorized to place into effect tariff sheets which will produce annual electric operating revenue of $174,916,000 which represents an increase of $15,793,000 or 9.93% in base rate tariff revenues; such revenue will provide MidAmerican with an opportunity to earn the rate of return set forth in Paragraph 6 above based on the test year herein approved, with such tariff sheets to be applicable to service furnished on and after their effective date;

(10) the interclass revenue allocation, rate design, and tariff terms and conditions discussed and accepted in the prefatory portion of this Order are just and reasonable for purposes of this proceeding and should be adopted;

(11) the new tariff sheets authorized by this Order should be filed within ten (10) business days and should reflect an effective date not less than four (4) business days after the date of the compliance filing, with the tariff sheets to be corrected within that time period if necessary;

(12) that the $701,292,619 original cost of plant for MidAmerican at December 31, 2012, as reflected on the Company’s Schedule B-4, Page 4 of 4, line 81, Column(e) is unconditionally approved as the original cost of plant;

(13) that MidAmerican's regulatory asset associated with recovery of original cost for certain generation assets, which assets have been written down in accordance with GAAP reporting on the MidAmerican Form 21 ILCC as a result of the 1997 Customer Choice and Rate Relief Law (220 ILCS 5/16-111) is hereby approved;

(14) The Commission has considered the costs expended by the Company to compensate attorneys and technical experts to prepare and litigate this rate case proceeding and concludes that such costs in the total amount of $181,000 for outside counsel and travel, meals, lodging and supplies, which is $36,200 when amortized over 5 years, are just and reasonable pursuant to Section 9-229 of the Act. 220 ILCS 5/9-229; and

(15) all objections, petitions or motions in this proceeding, which remain undisposed of, should be disposed of in a manner consistent with the ultimate conclusions contained in this Order.

IT IS THEREFORE ORDERED that the tariffs presently in effect for electric service rendered by MidAmerican Energy Company are hereby permanently canceled and annulled effective at such time as the new electric tariff sheets approved herein become effective by virtue of this Order.

IT IS FURTHER ORDERED that the Filed Rate Schedule Sheets proposing a general increase in electric rates, filed by MidAmerican Energy Company on December 16, 2013, are permanently canceled and annulled.

IT IS FURTHER ORDERED that MidAmerican Energy Company is authorized and directed to file new tariff sheets with supporting workpapers in accordance with Findings (9), (10), (11) and (12) of this Order, applicable to electric service furnished on and after the effective date of said electric tariff sheets.

IT IS FURTHER ORDERED that the $701,292,619 original cost of plant for MidAmerican at December 31, 2012, as reflected on the Company's Schedule B-4, Page 4 of 4, line 81, Column(e) is unconditionally approved as the original cost of plant is unconditionally approved as the original cost of plant for consideration of 83 Ill. Adm. Code 510.

IT IS FURTHER ORDERED that MidAmerican's regulatory asset associated with recovery of original cost for certain generation assets, which assets have been written down in accordance with GAAP reporting on the MidAmerican Form 21 ILCC as a result of the 1997 Customer Choice and Rate Relief Law (220 ILCS 5/16-111) is hereby approved.

IT IS FURTHER ORDERED that any objections, petitions, or motions in this proceeding that remain undisposed of are hereby disposed of consistent with the ultimate conclusions herein contained.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code Section 200.880, this Order is final; it is not subject to the Administrative Review Law.

DATED:	September 4, 2014
BRIEFS ON EXCEPTIONS	September 25, 2014
REPLY BRIEFS ON EXCEPTIONS	October 9, 2014

Heather Jorgenson
Administrative Law Judge